CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 963

TO AUTHORIZE LOANS AT INTEREST RATES IN EXCESS OF CERTAIN STATE USURY CEILINGS

AND

S. 1406

TO AMEND THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980

JULY 9, 16, AND 21, 1981

Printed for the use of the
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CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981

THURSDAY, JULY 9, 1981

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met at 9:35 a.m. in room 5302 of the Dirksen Senate Office Building; Senator John Tower, chairman of the subcommittee, presiding.

Present: Senators Tower, Lugar, Dodd, and Dixon.

OPENING STATEMENT OF SENATOR TOWER

Senator TOWER. Will the committee please come to order.

Today we are considering S. 1406, the Credit Deregulation and Availability Act of 1981, and S. 963, a bill to amend the Depository Institutions Deregulation and Monetary Control Act of 1980. The purpose of both bills is to alleviate many of the marketplace problems created by overly restrictive interest rate ceilings.

S. 1406 would completely preempt all State usury ceilings on consumer, agricultural, and business credit, and would also eliminate the Federal ceiling that controls the rate of interest that can be charged by Federal credit unions. This bill would continue the precedent set by the Depository Institutions Deregulation Act of 1980, of decontrolling interest rates, and would thereby free up the marketplace for all types of credit transactions.

S. 963 contains a more limited preemption, and would set an alternative Federal ceiling for all loans.

The legislators of my State, Texas, have recognized the detrimental effects of limited credit availability created by restrictive usury ceilings, and have taken responsible action to alleviate the problem. This May, Texas enacted legislation which allows the interest rate ceiling on most personal, automobile, and similar loans to rise to as much as 24 percent annually. In fact, more and more States are now beginning to revise their usury ceilings upward.

However, restrictive interest rate ceilings continue to be a problem of national scope and importance. Although many States have acted to alleviate the problems of scarce credit by raising permissible interest rates to some degree, several of them continue to have overly restrictive interest rate ceilings which disrupt and distort the marketplace, both within and outside their respective States.

I look forward to the testimony that will be presented today, and the insight it will give us into the issue of interest rate ceilings and the Federal preemption of such ceilings.

[Copies of the two bills being considered and the opening statement of Chairman Garn follow:]

II

97TH CONGRESS
1ST SESSION

S. 963

To authorize loans at interest rates in excess of certain State usury ceilings.

IN THE SENATE OF THE UNITED STATES

APRIL 9 (legislative day, FEBRUARY 16), 1981

Mr. BUMPERS (for himself and Mr. PRYOR) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To authorize loans at interest rates in excess of certain State usury ceilings.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 is amended by adding at the end thereof the following:

"PART D—GENERAL USURY OVERRIDE

"OTHER LOANS

"SEC. 531. (a) If the applicable rate prescribed in this section exceeds the rate a person would be permitted to

charge in the absence of this section, such person may in the case of any loan, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any such loan, interest at a rate of not more than 1 per centum in excess of the discount rate, including any surcharge thereon, on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the person is located.

"(b) If the rate prescribed in subsection (a) exceeds the rate such person would be permitted to charge in the absence of this section, and such State imposed rate is thereby preempted by the rate described in subsection (a), the taking, receiving, reserving, or charging a greater rate than is allowed by subsection (a), when knowingly done, shall be deemed a forfeiture of the entire interest which the loan carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person who paid it may recover, in a civil action commenced in a court of appropriate jurisdiction not later than two years after the date of such payment, an amount equal to twice the amount of interest paid from the person taking, receiving, reserving, or charging such interest.

"(c) For the purpose of this part—

"(1) the term 'loan' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals or other extensions of credit made by or to any person or organization;

"(2) the term 'interest' includes any compensation, however denominated, for a loan;

"(3) the term 'organization' means a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, association, or other entity; and

"(4) the term 'person' means a natural person or organization.

"EFFECTIVE DATE OF PART D

"SEC. 532. (a) The provisions of this part shall apply only with respect to loans made in any State during the period beginning on July 1, 1981, and ending on the earlier of—

"(1) April 1, 1983, or

"(2) the date, on or after July 1, 1981, on which such State adopts a law or certifies that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to loans made in such State,

except that such provisions shall apply to any loan made on or after such later date pursuant to a commitment to make such loan which was entered into on or after July 1, 1981, and prior to such later date.

"(b) A loan shall be deemed to be made on or after July 1, 1981, if such loan—

"(1) is funded or made in whole or in part after July 1, 1981, regardless of whether pursuant to a commitment or other agreement therefor made prior to July 1, 1981;

"(2) was made prior to July 1, 1981, and bears or provides for interest on or after July 1, 1981, on the outstanding amount thereof at a variable or fluctuating rate; or

"(3) is a renewal, extension, or other modification made on or after July 1, 1981, of any loan, if such renewal, extension, or other modification is made with a written consent of any person obligated to repay such loan.

"(c) This part does not apply to any loan secured by a residential manufactured home unless the loan meets the requirements of section 501(c).".

II

97TH CONGRESS
1ST SESSION

S. 1406

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

IN THE SENATE OF THE UNITED STATES

JUNE 22 (legislative day, JUNE 1), 1981

Mr. LUGAR (for himself, Mr. GARN, Mr. PROXMIRE, and Mr. D'AMATO) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Credit Deregulation and Availability Act of 1981".

TITLE I—BUSINESS AND AGRICULTURAL CREDIT

SEC. 101. Section 511 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96-221) is amended to read as follows:

"SEC. 511. (a) The provisions of the constitution or the laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the method of calculating or providing or contracting for interest, discount points, a time price differential, finance charges or other fees or charges that may be charged, taken, received, or reserved shall not apply in the case of business or agricultural credit.

"(b) 'Agricultural credit' means credit extended primarily for agricultural purposes to a person that cultivates, plants, propagates, or nurtures an agricultural product. 'Agricultural purposes' include the production, harvest, exhibition, marketing, transportation, processing, or manufacturing of an agricultural product and the acquisition of farmland, real property with a farm residence and personal property and services used primarily in farming. 'Agricultural product' includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish and any products thereof, including processed and manufactured products and any and all products raised or produced on farms and any processed or manufactured products thereof.

"(c) 'Business credit' means credit extended primarily for business or commercial purposes, including investment, and any credit extended to a person other than a natural person.

"(d) 'Credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit.".

SEC. 102. Section 512 of the Depository Institutions Deregulation and Monetary Control Act of 1980 is amended to read as follows:

"SEC. 512. (a) Except as provided in subsection (b) of this section, the provisions of this part shall apply with respect to business and agricultural credit extended on or after April 1, 1980.

"(b) The provisions of this part shall not apply to any business or agricultural credit extended in any State after the effective date (if such effective date occurs on or after April 1, 1980, and prior to three years after the effective date of the Credit Deregulation and Availability Act of 1981) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to credit extensions subject to the laws of such State, except that such provisions shall apply to any credit extended on or after such date pursuant to a commitment to extend such credit which was entered into on or after April 1, 1980, and prior to such later date.

"(c) Credit shall be deemed to be extended during the period to which this provision applies if such credit extension—

"(1)(A)(i) is funded or made in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to April 1, 1980;

"(ii) was made prior to or on April 1, 1980, and bears or provides for interest during such period on the outstanding amount thereof at a variable or fluctuating rate; or

"(iii) is a renewal, extension, or other modification of an extension of credit made prior to April 1, 1980, and such renewal or extension or other modification is made during such period with the written consent of any person obligated to repay such credit; and

"(B)(i) has an original principal amount of $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the date of enactment of the Credit Deregulation and Availability Act of 1981); or

"(ii) is part of a series of advances if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to a commitment or other agree-

ment therefor is $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the date of enactment of the Credit Deregulation and Availability Act of 1981); or

"(2) is a renewal, extension, other modification or use of a credit agreement or extension made during such period, including an agreement entered during that period that contemplates future extensions of credit from time to time in which the charges that are assessed for or in connection with credit are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.".

TITLE II—CONSUMER CREDIT

SEC. 201. Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96-221) is amended by adding at the end thereof the following new subpart:

"PART D—CONSUMER CREDIT

"SEC. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be

charged, taken, received or reserved shall not apply to an extension of consumer credit made by a creditor.

"SEC. 532. (a) As used in this part, the terms set forth below shall be defined as follows:

"(1) 'Covered charges' means—

"(A) interest, discount points, a time price differential, fees, charges or any other compensation paid to the creditor or arising out of the credit agreement or transaction for the use of credit or credit services. The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor; and

"(B) fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees.

"(2) 'Credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit, all without regard to the nature of any property that might secure its repayment.

"(3) 'Creditor' means any person that regularly makes extensions of consumer credit, which, for purposes of this definition, shall include extensions of credit that are subject to the provisions of section 501(a) of this title. A person is not a 'creditor' with respect to a specific extension of consumer credit if, except for this part, in order to assess or collect covered charges in connection with that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law.

"(4) 'Extension of consumer credit' means any credit extended to a natural person primarily for personal, family, or household purposes, except that it does not include credit subject to the provisions of section 501(a) of this title.

"SEC. 533. (a) Except as provided in subsection (b) of this section, the provisions of section 531 shall apply with respect to any extension of consumer credit made by a creditor on or after the effective date of the Credit Deregulation and Availability Act of 1981.

"(b)(1) The provisions of section 531 shall not apply to any extension of consumer credit in any State made on or after the effective date (if such effective date occurs on or after the effective date of the Credit Deregulation and Availability Act of 1981 and prior to a date three years after such effective date) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to extensions of consumer credit subject to the laws of such State, except that such provisions shall apply to any consumer credit extended on or after such date pursuant to an agreement to extend such credit which was entered into on or after the effective date of the Credit Deregulation and Availability Act of 1981 and prior to such later date.

"(2) Credit shall be deemed to have been extended during the period to which this provision applies, if it—

"(A) is funded or extended in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period;

"(B) was made prior to such period and bears or provides for covered charges that may vary or fluctuate during that period;

"(C) is a renewal, extension, or other modification of a credit extension made before such period and such renewal, extension or other modification is made during such period with the written consent of any person obligated to repay such credit; or

"(D) is extended in accordance with an agreement entered during that period that contemplates future extensions of consumer credit from time to time in which the covered charges are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.

"(c) Any law or certification adopted by a State or its voters pursuant to subsection (b) of this section may specify that portion of the extensions of consumer credit made in such State, or those types or kinds of covered charges, to which the provisions of section 531 will not apply.

"Sec. 534. The Board of Governors of the Federal Reserve System is authorized to publish Board interpretations regarding the scope and application of section 531 of this part. Upon its own motion or upon the request of any creditor, State, or other interested party which is submitted to the Board in accordance with procedures it establishes, within sixty days the Board shall issue an official interpretation re-

garding the scope of section 531 and its relationship to specific provisions of State law, or shall make public a Board determination (accompanied by an appropriate explanation) that the question presented does not involve a significant issue or does not affect a substantial number of creditors or extensions of consumer credit.".

TITLE III—FEDERAL CREDIT UNIONS

SEC. 301. Section 1757(5)(A)(vi) of the Federal Credit Union Act is amended to read as follows: "rates of interest shall be established by the board of directors of the Federal credit union;".

TITLE IV—EFFECTIVE DATE

SEC. 401. The effective date of this Act shall be the date of enactment of this Act.

OPENING STATEMENT OF CHAIRMAN GARN

Senator GARN. As a cosponsor of the Credit Deregulation and Availability Act of 1981, I am pleased to see that prompt hearings are being held on that bill, as well as on S. 963, the more limited bill that has been introduced by Senators Bumpers and Pryer.

During the committee's recent oversight hearings, many of the witnesses testified about the severe marketplace dislocations that are occurring due to overly restrictive usury laws. It was on the basis of that evidence that I have cosponsored Senator Luger's bill. Now we must specifically focus upon the problems created by usury laws, their impact upon various industries and consumers, and possible legislative solutions to these problems.

The precedent for deregulation of interest rates was set in the last Congress by the Depository Institutions Deregulation Act, when mortgage credit ceilings were preempted and business and agricultural rate limitations were partially deregulated. However, as I am confident that the testimony during these hearings will indicate, further action needs to be taken to alleviate the problems created by restrictive rate laws, particularly as they pertain to consumer credit.

Deregulation of credit rate ceilings is not only important because of marketplace dislocations, but also because of the imminent deregulation of interest rate ceiling on deposit accounts. Since Congress has mandated the phase out of rate restrictions on financial institutions' liabilities, deregulation of asset restrictions must also occur. It is inherently obvious that financial institutions will never be able to pay market rates to savers if they cannot charge market rates for credit.

Deregulation should also be very helpful to the thrift industry. Although thrifts were granted the authority to engage in consumer lending as part of the Deregulation Act of 1980, they now have little incentive to diversify into this area of lending so long as restrictive rate ceilings make it unprofitable. If thrifts were able to profitably acquire short-term loans, the resulting diversification of their portfolios could be beneficial.

While providing for marketplace relief through deregulation of interest rates, Senator Lugar's bill, S. 1406, leaves credit regulation to the States. Not only does it permit the States 3 years within which to reject the preemption and reimpose rate controls, but it also specifically leaves consumer protection measures within the jurisdiction of the States. S. 1406 does not interfere in any way with State consumer protection and licensing laws and I believe this is a very important aspect of any deregulation legislation.

I look forward to these hearings and the information it will give us on the scope of this problem and appropriate solutions.

Senator TOWER. Our first witnesses this morning are the two distinguished Senators from a State, Arkansas, that has a particular affliction with usury rate ceilings, Senator Dale Bumpers and Senator David Pryor.

Senator Pryor, I don't believe Senator Bumpers is here yet, so we will let you take center stage.

Senator PRYOR. Mr. Chairman, I appreciate that.

Senator TOWER. If you will get started first, we'll wait until we hear from both of you before we submit questions.

Senator PRYOR. Mr. Chairman, I do appreciate that. I was just informed Senator Bumpers is on his way. But we may as well go ahead.

Senator TOWER. I understand he is on his way, and you can go ahead and finish your testimony. I'm sure he won't mind if you complete yours; and then, we'll hear from him when he gets here.

Let me say that if you would like to summarize your statement orally, your complete written statement will appear in the record. And I would say that to all witnesses: that we would include your complete statements in the record. If you would summarize them in the interests of time, and of illuminating the pertinent points, I think it would be a good idea, to the extent that you can do it, because we do have a number of witnesses this morning.

Mr. Pryor, we are delighted to welcome a good neighbor to the Financial Institutions Subcommittee.

STATEMENT OF DAVID PRYOR, U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator PRYOR. You're very kind, Mr. Chairman, to allow Senator Bumpers and me, and others who will be coming—the Arkansas Automobile Dealers Association, and the National Home Furnishings Association people—to testify.

I do have a short statement, Mr. Chairman, that I have reduced from a longer statement, which is being submitted for the record.

[The complete statement follows:]

TESTIMONY OF
SENATOR DAVID PRYOR
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS
JULY 9, 1981

Mr. Chairman, I appreciate the opportunity to come before the committee this morning to discuss--once again--the effects of overly restrictive usury laws and to appeal for the extension of temporary, limited relief to retailers, who were excluded from the consumer lending preemption of last year's Depository Institutions Deregulation and Monetary Control Act.

The effects of the 10% interest rate limit contained in Arkansas' 1874 constitution can be seen throughout the state's economy as much-needed capital has left my state for more profitable climates: Since 1974, when the prime rate began its see-saw rise and fall, real personal income in the state of Arkansas has decreased by twice the amount of the national average. Overall, almost 6,000 more jobs would have existed in Arkansas at the end of 1980 if the state had performed like the nation. If these jobs existed, Arkansas' February, 1981, unemployment rate would have been 8.7 percent, instead of 9.3 percent.

Though not alone in its suffering from high interest rates and inflation, Arkansas suffers inordinately due to its unique 10 percent usury limit, which is lower than any other state in the nation. Auto dealers, furniture, appliance and other retailers in the state must finance their inventories at one or two percentage points above the prime lending rate

but can extend credit to their customers at no more than 10 percent. Rising costs, tightened consumer credit, shortened repayment periods and laid off employees have been the result, and sales of kitchen appliances, furniture and automobiles continue to decline.

Particularly hard hit have been the automobile dealers of Arkansas. Many auto dealers who are dependent upon General Motors Acceptance Corporation (GMAC), Ford Motor Credit, and Chrysler Credit have been faced with increasingly strict credit policies. For example, as of January 1, 1980, GMAC withdrew collision, conversion and confiscation coverage (so-called 3C coverage), which exposes auto dealers to all losses incurred on repossessed vehicles. Ford has limited its 3C coverage, and Chrysler has completely eliminated it.

As of March, 1981, GMAC has refused to finance new non-GM cars and trucks and will finance only those used non-GM cars which are traded in on a new GM car or truck. The seriousness of these stricter credit policies is such that, according to the president of the Arkansas Automobile Dealers Association, if relief legislation is even another six months in being passed, up to 50 percent of the automobile dealers in the state will be out of business.

The National Automobile Dealers Association found in May, 1980, that fifty percent of the automobile sales contracts being lost nationally were due to the inability of consumers to obtain financing. Just this week the Washington Post reported

that new car sales among the big three auto industries declined significantly last year while industry-wide figures could be the worst in at least 17 years. Though the drastic reduction in consumer credit which consumers are experiencing during the recent period of high interest rates is not solely due to state usury limits, there is no doubt that it has been a major contributor to the critical situation we now face.

It is ironic that usury limits first established as protection for the poor against extortionate interest rate charges have now been surpassed by the rapid escalation of the prime lending rate. With the prime rate hovering around 20 percent, this "protective" mechanism is having the opposite effect. Instead of facilitating the economic development of a historically stagnant state economy, Arkansas' usury limit is choking the small businessman out of existence.

Not only automobile dealers but equipment dealers, furniture companies and appliance dealers are in need of relief. A recent Wall Street Journal article, which I have included in the record, describes the inevitable bankruptcy of a music store in Arkansas--well managed, supplying a need to the community--which was simply caught in the interest rate squeeze. I have spoken with a number of other businessmen in my state who are in the same boat and who are asking for immediate help.

I think that we are all agreed on the evils of unreasonable interest rate restrictions, and Congress by now is well aware of Arkansas' peculiar situation. We may differ, however, in the lengths to which we will go to correct the distortions created when interest rate limits are well below market rates.

Last year as part of the Financial Instituations Deregulation and Monetary Control Act the Congress adopted several federal overrides of state usury ceilings. As we stand now, lenders may charge 5 percent over the Federal Reserve's discount rate on business and agricultural loans of $1,000 or more notwithstanding state laws or constitutional provisions. Mortgage loans may be made at any rate, and state chartered financial institutions may now make any loan at 1 percent over the discount rate, as national banks have been allowed to do since 1933. These provisions were necessary and helpful and have done a great deal to strengthen the economy of my state and, I am sure, the home states of many of my colleagues.

Since the enactment of that legislation, however, we have come to realize that the coverage of the preemptions is a bit too narrow. As the law is now written, it applies, with one exception, to federally insured banks, savings and loans, mutual savings banks, credit unions, small business investment companies and certain other financial institutions. Not included under the consumer loan authority are automobile dealers, furniture and appliance firms and other retailers.

The intent of the bill which Senator Bumpers and I have introduced, S.963, is to allow any person or organization to extend consumer credit on the same terms as financial institutions under the omnibus bill of last year. The provisions of the legislation would extend until April 1, 1983, and the states would be allowed to override the federal preemption at any time. Representative Bill Alexander, also of Arkansas, has introduced the same bill in the House of Representatives.

There is one change that I should like to make to the original text. As now written, our bill would allow a surcharge (currently 4 percent) to be tacked on to the discount rate in computing the new interest rate ceiling. I should prefer to see the bill amended to limit the allowable rate to 1 percent with no added surcharge. Banks, S&L's and other financial institutions are currently not permitted to add the surcharge, and the purpose of our bill is merely to bring retailers to parity with these institutions.

Obviously, the Lugar-Garn-Proxmire-D'Amato bill would eliminate the restrictions which have plagued our auto dealers and other retailers. It seems to me, though, that in this bill you are giving us too much relief.

We can all agree that in theory the market should be free to set the price of money like the price of other goods, and I have no doubt that Adam Smith is smiling down on your effort. But I believe that there is a strong sentiment in

this country for some sort of protection against unreasonably high interest rates. Although not in keeping with free market economic theory, this sentiment is understandable in view of interest rates which keep bobbing above the 20 percent mark. Almost every state has interest rate limits of one sort of another. Some are applied only to consumer loans, some only to home mortgages, some are very close to or below market rates, and others are high enough to let the market set the going rate except under extraordinary circumstances. But in any event, there is a clear desire for a safety net.

As I mentioned, our bill has a sunset date of April 1, 1983. The auto dealers and retailers in our state have said that while the relief we are offering will not take the place of market level interest rates, it will help them limp along and stay in business until the state of Arkansas can take care of its own problem through a change in its constitution. There is a sincere desire in Arkansas to solve the problem from within--even though we have had to come to the Congress to buy some time.

By sunsetting federal preemption legislation, the Congress would put pressure on Arkansas and other states to take appropriate steps to reconcile market interest rates and protective measures necessary to reassure their citizens. While I believe that the federal government has the authority to eliminate restrictions on interstate commerce (especially since federal policies help to determine the cost of money), I prefer to leave as much authority as possible to the states.

And the states have been active. At last count, 19 states and the District of Columbia were in the process of revising their interest rate ceilings.

Arkansas, of course, has a harder time than most since its constitution is more difficult to amend than other states' statutes. Last November the people of Arkansas rejected a new constitution which would have allowed the State Legislature to set interest rate ceilings from now on; however, a separate amendment which would have pegged the interest ceiling to the discount rate, was approved by 44 percent of the voters, close to a majority. This vote indicates to me that most people recognize the fluctuating nature of interest rates but are not prepared to give up all protection against the possibility of lenders charging unreasonable rates.

Continuing the states' rights theme, I feel that the most important provision of either bill is the one which allows the states to override the federal preemption. Without such an "escape clause" I could not have voted for any of the preemption legislation, and we must be aware that at least seven states have already taken advantage of it. Because many states may not bump up against their own ceilings for some time to come, however, they may not have the incentive to act within the three-year limit established by S.1406. But they may eventually wish to reimpose their own limits, and for this reason I do not believe that we should limit the override period.

In summary, then, I prefer the more modest approach of S.963 to the sweeping changes embodied in S.1406 for two reasons: because the American people have indicated that they are fearful of the power of lending institutions and wish to keep some reasonable interest rate limit and because I believe that the states should be encouraged to meet the issue and should be free to make any adjustments which may be necessary to meet local conditions.

I want to end by thanking the Banking Committee for, once again, taking the time to consider the peculiar usury problems of the people of Arkansas. Members of this committee have always turned a sympathetic ear to our concerns and certainly came to our rescue in a big way last year. I thank you for this opportunity to explain our bill to extend the provisions of last year's bill and to discuss generally the approach we should take to the question of interest rate limits.

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Senator PRYOR. We do appreciate the opportunity to discuss the effects of overly restrictive usury laws, and to make an appeal for the extension of temporary, limited relief to retailers, who were excluded from the consumer lending preemption of last year's Depository Institutions Deregulation and Monetary Control Act.

I think we have all agreed on the problems that are created by excessive interest rate restrictions, and the Congress, I think, is now painfully aware of Arkansas' peculiar situation—we adopted, as the chairman knows, in 1874, a constitutional ceiling on interest rates, of 10 percent—we may differ, however, in the lengths to which we will go to correct the distortions created when interest rate limits are well below market rates.

The intent of the legislation which Senator Bumpers—who has just arrived—and I have introduced, S. 963, is to allow any person or organization to extend consumer credit on the same terms that State financial institutions achieved under the omnibus bill last year.

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I must state at this point, Mr. Chairman, that there is one area that gives me some concern, and I think might be subject to further discussion. That is a section in our legislation that relates to the surcharge fee. I won't go into that at this time, but I think at the proper time, we might find an opportunity to discuss whether a surcharge of 4 percent should stay in this legislation, or be removed or modified.

Obviously, the Lugar-Garn-Proxmire-D'Amato bill would go much further than Bumpers-Pryor. This is the legislation S. 1406. It is my own personal opinion, Mr. Chairman, that there might be too much relief being granted in this bill. We can all agree that in theory the market should be free to set the price of money, like the price of other goods, and I have no doubt that Adam Smith is smiling down on your effort.

I do believe, however, that—especially in these times of volatile interest rates—there is a very strong sentiment around the country for some sort of protection against unreasonably high rates. As evidence of that sentiment, I think we should consider that all but about three States have interest rate limits of one sort or another.

I also feel that whenever possible, the Federal Government should let the States meet this sort of problem in their own way. And it's worth noting that at last count, some 19 States and the District of Columbia were in the process of revising their interest rate ceilings. Continuing this States' rights theme, I feel the most important provision of either of these bills is the one which does allow the States to override the Federal preemption. Without such an escape clause, I don't think I could have voted for any of the preemption legislation. We must be very aware that at least seven States have already taken advantage of this out.

I'm concerned about the 3-year override period in Senate bill 1406, and I would rather see States able to reimpose their own laws any time they wish.

Mr. Chairman, I would like to end by once again thanking you and thanking this committee for taking the time to consider the singular usury problem of the people of Arkansas. It has been one which has plagued and baffled us for many years. It has presented many, many problems to our State, and members of this committee, Mr. Chairman, have always turned a most sympathetic ear to our concerns. You certainly came to our rescue in a big way last year.

We thank you once again for your attention.

I see that my senior colleague is here. Senator Bumpers, I apologize for going before you, but I appreciate the opportunity to appear with you today before the Banking Committee.

Senator TOWER. Thank you very much, Senator Pryor.

Senator Bumpers, I hope you won't feel offended that we went ahead and started without you. We've got a lot of witnesses this morning. We're delighted you're here, and we look forward to your testimony.

STATEMENT OF DALE BUMPERS, U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator BUMPERS. Thank you. It took me longer to get an elevator than it did to get to work this morning. [Laughter.]

Senator Tower. I'll have to speak to the Rules Committee about that. [Laughter.]

Senator Bumpers. First, I want to thank you very much, and the chairman of the committee, Senator Garn, for holding these hearings. I offered this bill as an amendment on the floor not long ago, and Senator Garn assured me that he would hold hearings in connection with all of the interest rate-related legislation before this committee.

But the genesis of this, of course, is to correct some inequities that developed last year. We are really here not because Senator Pryor and I like high interest rates; we are here because the retailers at every level—from the automobile dealers, on down—in our State are facing what can only be described as a catastrophe.

Last year, Mr. Chairman, you know when we passed the omnibus banking bill, we did three things in that bill:

First, we provided that any federally related institution could charge 1 percent above the Federal discount rate. Federal banks have had that privilege since 1932, and we extended that to all Federally related institutions.

No. 2, we lifted the interest rate entirely on mortgage loans.

The third thing we did was to provide that any person—federally related or not—could make agriculture or business loans at 5 percent above the Federal discount rate. At that time, the rate was 13 percent; as you know, it's now 14 percent.

Now, the problem with that is, as I said a moment ago, there are some things we omitted. For example, right now the merchants in my State are limited to a 10-percent usury rate in the constitution, so the State legislature can't change it. And they're having to finance their inventories.

I have a good friend in the furniture business, in a city I will not mention. He has three stores. And he called me last week to tell me he was closing his biggest downtown store. He has $200,000 borrowed at the local bank, at 22 percent. And if he sells a refrigerator, for example, he has to finance that refrigerator at 10 percent, because the omnibus banking bill last year did not give him the right to charge the going rate. So he has a $200,000 inventory, financed at 22 percent. GECC will finance his refrigerators, and his furniture, and everything else, but only on a discount basis, which is about what his profit is. He says that on a $60 profit on a $300 refrigerator, the discount rate takes his profit. So all he's doing is sitting there, losing money, because of this.

Now, I want to focus for a moment on the automobile dealers in my State and at this point I'll just submit my formal statement for the record.

[The complete statement follows as though read:]

STATEMENT OF SENATOR BUMPERS

Senator Bumpers. Mr. Chairman, I thank you for the opportunity to testify in support of S. 963. Creditors in Arkansas are in desperate straits, and I appreciate the willingness of the members of this committee to give prompt attention to the crisis these bills attempt to resolve.

Mr. Chairman, retailers and auto dealers in Arkansas are facing an emergency financial situation of epidemic proportions. Members

of this body, including myself, sometimes use hyperbolic phrases and words in an effort to persuade or get the attention of other Senators, and the risk in doing this is that when a real emergency arises we will have cried wolf once too often and our pleas will be ignored. I hope that the members of this commmittee do not believe that Senator Pryor and I are crying wolf about the credit crisis in Arkansas. It is real. It is severe. And it demands immediate attention.

As every member of this committee is aware, during the last Congress we passed an omnibus banking bill that contained provisions overriding State usury laws in limited circumstances. First, we provided that any federally related institution—such as a federally chartered bank or credit union, or a State bank or savings and loan insured by the FDIC or FSLIC—could charge 1 percent above the Federal discount rate on any loan. Second, we eliminated State interest ceilings on mortgage lending. And third, we provided that any person, not just a financial institution, could charge up to 5 percent over the Federal discount rate on a business or agriculture loan. These provisions were welcomed by Arkansas banks, savings and loans, and those in the business of making loans for homes or for business and agriculture purposes. I was, and am still, delighted that we could provide temporary relief to these businesses.

At the same time, Mr. Chairman, the legislation we passed created inequities that S. 963 will resolve. Let me give just one example. Under current law as enacted last Congress, as I mentioned, any person may charge up to 5 percent over the Federal discount rate for a business or agriculture loan. This means that a merchant in Arkansas may have to pay 21 percent or higher for loans on his inventory. At the same time, this merchant that sells, say, refrigerators, is still limited by the 10 percent ceiling in the Arkansas Constitution in making loans to his customers. So he must borrow at 21 percent, but may only lend at 10 percent. It takes no economist to understand that this merchant can't continue to do business this way for very long. This example describes the situation in which hundreds and probably thousands of Arkansas businesses find themselves.

Mr. Chairman, I abhor the notion that all problems can best be solved by the Federal Government. Such a philosophy is in part responsible for the rapid growth of Government in recent years, and I commend the Reagan administration for working toward the goal of placing realistic limits on Federal spending and returning the responsibility for dealing with many problems back to the States. But there are instances in which relief in the form of Federal legislation is necessary to deal with a problem national in scope. It is sometimes necessary for Congress to step in to enact legislation to save lives or to deal with a crisis the States are incapable of solving. We should not do so lightly, especially in an area such as the regulation of interest rates that historically the States have regulated themselves. So it is with some trepidation that Senator Pryor and I are asking Congress to provide the relief specified in S. 963.

Maximum interest rates that can legally be charged are a matter of constitutional law in Arkansas. Article 19, section 13 of the Arkansas Constitution states that all contracts for a greater rate of

interest than 10 percent shall be void; 10 percent has been the maximum allowable rate of interest in Arkansas since 1874. This provision is 107 years old. It made sense back in 1874 to put a strict limit on interest, but it is simply unrealistic in today's money markets. I want the members of this committee to understand that since the usury rate is set by the Arkansas Constitution, it cannot be changed by the Arkansas Legislature as it can in other States. It takes an amendment to the Arkansas Constitution.

Mr. Chairman, these are extraordinary times. The rapid escalation of interest rates in national markets has resulted in the prime rate surpassing most State usury limits. And when that happens, as it did several years ago in Arkansas, State usury limits no longer serve the purpose for which they were designed. During the decade of the sixties, the prime rate was changed only 15 times. During 1980 alone, the prime rate was changed 60 times and hit 20 percent in April 1980; 4 months later it was at 11 percent, and then again last December it was at 21.5 percent. It has been in the range of 17 percent to 20.5 percent since January of this year. In these times, a 10-percent ceiling is totally unrealistic.

State usury limits are severely hurting all kinds of small businesses in Arkansas. The problems that are being experienced by auto dealers exemplify the reasons why relief is necessary. The Nation's auto industry has been, and continues to be, in desperate straits. Production and sales are down dramatically and unemployment within the industry and within allied industries is high. As far as the small business dealer is concerned, the attrition rate is staggering. Over 1,600 dealers have closed their doors since January 1, 1980, and over 100,000 employees of dealers have lost their jobs.

In April of last year the National Automobile Dealers Association performed a random survey of dealers from across the country and found that about 30 percent of their sales contracts were being lost because of an inability of consumers to obtain financing. By May, this figure had jumped to an astounding 50 percent. In many cases, the inability of lending institutions to charge the going rate resulted in their withdrawal from the business of financing auto loans.

The situation is worse in Arkansas than in other States. Many creditors that auto dealers depend on to finance auto sales—such as GMAC, Ford Motor Credit, and Chrysler Credit—have established strict credit policies. In January 1980, GMAC withdrew collision, conversion, and confiscation coverage, known in the industry as the 3C coverage, which exposes dealers to all losses resulting from repossessed vehicles. Shortly after GMAC took this action, Ford limited its 3C coverage and Chrysler has withdrawn it completely. More recently, since March 31 GMAC has refused to finance new non-GM cars or trucks for Arkansas dealers, and the only used cars that are eligible for GMAC financing are those traded in on the purchase of a new GM car or truck.

Mr. Chairman, many Arkansas dealers will go broke in the next few months without some kind of relief. It would, of course, be nice if interest rates would drop dramatically, but no one is predicting that this will happen in the near future, and so these thousands of small business men and women in Arkansas have nowhere else to

turn but to Congress. I want to reemphasize that this is not a problem the Arkansas Legislature can solve.

Let me just briefly provide some additional figures that illustrate the effect that the constitutional usury limit is having on the Arkansas economy. The prime rate reached 12 percent in July 1974, and since then Arkansas has failed to advance in comparison to the national per capita income. From 1958 to 1974, before the credit crunch, the per capita income in Arkansas increased from 62.3 percent to 78.7 percent of the national average. That is a fairly dramatic increase. During that growth period, Arkansas' growth was at a 7.84-percent compounded annual rate, or 1.57 percent a year faster than the national rate of 6.27 percent. Since 1974, however, Arkansas' per capita income has increased at a rate slower than the national average.

Real personal income fell in 1980, both for Arkansas and the United States as a whole, but Arkansas decrease was almost twice the national percentage—−4.959 percent versus −2.608 percent. In earlier recessions, when inflation and interest rates were lower, Arkansas suffered less than the Nation as a whole. But in recent years Arkansas has suffered more, in part because it simply is not competitive at current levels of inflation and interest rates. Almost 6,000 more jobs would have existed in Arkansas at the end of 1980 if the State economy has performed like that of the Nation as a whole. I do not claim that enactment of S. 963 will be a panacea for the Arkansas economy, but it will go a long way toward relieving the State's credit problems and will generally increase confidence in the States's economy.

S. 963 is, in my view, a rational and reasoned response to Arkansas' dilemna. It simply extends to all creditors the right to charge the same rate of interest that banks are currently allowed to charge under Federal law—that is, 1 percent over the Federal discount rate. This authority would expire April 1, 1983, or sooner if the voters in a State reject it. In November 1982, Arkansas voters will again go to the polls to vote on a proposed constitutional amendment that will increase Arkansas interest ceiling to a more acceptable level. I realize that this problem must ultimately be resolved at the local level, but until it is, small businesses in Arkansas have no place else to turn except to Congress for this emergency relief.

Mr. Chairman, I am submitting for the record an article that appeared on the front page of the Wall Street Journal on May 22, 1981, entitled "Arkansas Retailers Say Usury Law Threatens Wholesale Closedowns" and some tables that depict Arkansas unemployment and per capita income (see p. 32). I urge the immediate and favorable consideration of this bill.

I will discuss this in ways that we can all relate to and understand. First of all, GMAC announced recently that they were not going to finance used cars for the dealers, nor were they going to finance non-GM automobiles—we have a lot of multiple dealerships, for example, a Chevrolet combined with a Toyota dealership—and GMAC will now finance a non-American made automobile.

Incidentally, I've always wondered why they financed them anyway, except they've been making money on it. That's the reason they did it.

Senator TOWER. That's a very good reason. [Laughter.]

Senator BUMPERS. It's compelling.

But now they've said: "We're not going to finance"—and this is just in Arkansas, I assume. But they are also saying:

We are not going to take the responsibility for the payments on those automobiles. In other words, if we have to repossess it, you've got to make the payment for that person that bought the automobile.

Well, in any event, you don't have to—as we say in Arkansas—be broken out with brilliance to know that dealers—automobile or otherwise—cannot finance their inventories at 22 percent, and sell their merchandise at 10 percent.

And the reason, I started to say a moment ago—the sense of urgency about this—I know that there is a bill pending here, that the chairman pretty much favors, to just raise all interest rates, so that we don't have States like Arkansas, who are strapped, coming in here and asking for special favors. I can tell you that nobody deplores asking for favors more than Senator Pryor and I do. We don't like it. This problem ought to be solved at the local level, but it cannot be solved with our legislature, because the 10 percent ceiling is in the Arkansas Constitution. Unless we get relief, we're going to have an unbelievable number of dealers—particularly automobile dealers—going belly up, unless we get some action on this almost immediately.

Finally, Mr. Chairman, I want to just give you some statistics, so that you will understand the economic dislocation that this has been causing. I want to give you some statistics that the industrial research and extention center in Arkansas has come up with:

The prime rate reached 12 percent in July 1974, and since that time, Arkansas—of course, because of this interest rate—has failed to advance, compared to the national per capita income rate.

Listen to this. From 1958 to 1974, before the credit crunch, the per capita income in Arkansas increased from 62.3 to 78.7 percent of the national average. In other words, that's a growth rate of 16 percent that we advanced on the national average, from 62 to 78 percent. That's a really dramatic increase. A lot of that took place under a couple of very dynamic governors they had there. [Laughter.]

But during that growth period, Arkansas' growth rate was at a 7.84 percent compounded annual rate, or 1.57 percent a year—faster than the national rate of 6.27 percent. And since 1974—since David became governor in 1974, I'm not going to give him any credit for this. [Laughter.]

Since 1974, Arkansas' per capita income has increased at a much slower pace than the national average. Real income fell in 1980—both for Arkansas and the United States as a whole—but Arkansas' decrease was almost twice the national percentage.

So, in short, Mr. Chairman, we would have easily over 6,000 jobs more in Arkansas right now, just since 1974, if we hadn't run into this terrible problem of an interest rate nationally that has run amuck, and been strapped with a 10 percent rate. I'm not suggesting that S. 963 is going to be a panacea, but I can tell you that

every small businessman in Arkansas is watching this hearing today with great interest—a lot of them are in this audience, I can tell you; a lot of them are here—who are facing disaster. They're here because it's their livelihood. They spent their lifetimes building their businesses, and now they see it all going down the tubes.

And finally, on behalf of Glen Black, who is president of the Arkansas Retail Merchants Association, Mr. Chairman, and who cannot be here, I would like to insert his written statement into the record, also.

Senator TOWER. Those documents will be included in their entirety in the record.

[The documents follow:]

(From the Wall Street Journal)

ARKANSAS RETAILERS SAY USURY LAW THREATENS WHOLESALE CLOSEDOWNS—CONSUMER-LOAN LID OF 10%, LOWEST IN NATION, RAISES PRICES AND CURBS LENDING

(By Brenton R. Schlender)

LITTLE ROCK, ARK.—When C. Bernie Allen first got into the record and home-entertainment business here 17 years ago, he never dreamed that his fate as a businessman would be determined by Arkansas voters.

But on the day following the election last November, he watched the choir of demonstrator television sets in one of his four suburban stores flash voting returns that confirmed his fears with chilling redundancy. Arkansas voters, fed up with inflation, higher taxes and steep mortgage interest rates, had chosen to retain the state's century-old 10 percent interest rate ceiling on consumer loans. Mr. Allen, who had been paying some out-of-state lenders more than 20 percent in interest to finance his stores' operations for several months, knew that he faced more red ink and possibly his day in bankruptcy court.

Sure enough, in early March his company, Moses Melody Shops Inc., filed for reorganization in federal bankruptcy court here, despite record Christmas sales and the layoff of half of his 72 employes. Now, Mr. Allen adds, the company is being liquidated.

"The load of carrying the difference between what we had to pay for money and what we could charge our customers for credit just got too heavy," the 49-year-old former minor-league third baseman explains. "The atmosphere for retail business in this state is like a morgue now."

VARIED COUNTERMEASURES

Hundreds of other furniture, appliance, soft-goods and automobile retailers in Arkansas also are being cramped by the lowest usury ceiling—and the stiffest penalties for violations—in the nation. To preserve profits, they have had to raise prices, tighten customer credit requirements, shorten repayment periods, lay off employes and discontinue free delivery and other services.

Federal legislation has taken Arkansas banks and savings and loan associations off the hook somewhat by allowing them to charge up to 15% on consumer loans and 23% on business and farm loans. But even the 15% limit is so low that many banks have nearly halted consumer lending; they prefer to divert funds to higher-yielding money-market certificates and other investments outside Arkansas.

"There's no other state quite like it," says Robert Devine, national coordinator for credit legislation for J.C. Penney Co. Not only is the Arkansas ceiling the nation's lowest, but Arkansas is the only state where interest rates are governed by the state constitution and not the legislature, he says. "In other words, it's just about impossible for retailers to operate there," he adds.

Moreover, experts say the strict ceiling and stiff penalties have compounded an historically stagnant state economy and thereby have damped economic development in Arkansas. Others blame the usury ceiling at least in part for a recent spate

of business bankruptcies and higher retail prices statewide. "It's hard to quantify exactly what the usury ceiling has done to harm Arkansas, but you know it has," says Jim Guy Tucker, a former congressman and currently an attorney for the Arkansas Bankers Association. It's just that a lot of the bodies haven't floated to the surface yet."

As the election last fall demonstrated, however, lots of people in Arkansas like the usury ceiling. That was the third time since 1968 that voters rejected proposed constitutional amendments, sponsored by a coalition of bankers, retailers and auto dealer, that would have allowed the legislature to set the interest-rate ceiling and reduce usury penalties.

The staunchest opponents of the proposals have been organized labor and consumer groups. They cite many reasons. They don't want to give legislators, many of whom have ties with banks, the authority to set the ceiling. And they don't want to dilute the penalty for making a usurious loan—complete forgiveness of all principal and interest.

THE PRINCIPAL ARGUMENT

Mainly, however, "We don't think it's right for retailers to make money on money," says J. Bill Becker, Arkansas AFL-CIO president. He also sees "nothing wrong with tight money" He contends that federal economic-growth barometers show that Arkansas, whose population grew 18.8% in the 1970s, "has done pretty darn good" even with the ceiling.

But signs of the ceiling's effects are all over Arkansas's retailing industry—from the small-town mom-and-pop furniture stores all the way up to big car dealers and department stores. Mr. Allen, for example, was able to carry $2 million in "customer paper" only by borrowing at high interest rate (up to 23% at some out-of-state finance companies), or by paying reluctant appliance finance companies such as Westinghouse Credit Corp. and General Electric Credit Corp. to back his credit customers. The most he could charge his customers, however, was 10% simple annual interest, with the debt to be paid in no more than 12 monthly installments.

"Most of those accounts were for about $50, and the customer would send you $5 a month," he moans. "That's almost as much as it cost us to mail out the monthly statements."

All those debt problems just to keep merchandise moving ultimately combined with the recession to run Mr. Allen out of business. Like Mr. Allen, his banker, William Bowen, chairman of Commercial National Bank here, blames Mr Allen's troubles on the usury ceiling. "Bernie Allen played a good game," Mr. Bowen says, "but he got caught in the trap."

Also being hurt is Dillard's Department Stores Inc., which is headquartered in Little Rock and operates seven of its 40 large stores in Arkansas. The company estimates that it lost $1.2 million in 1980 alone through borrowing from banks to cover its Arkansas credit customers. (Dillard's as a whole, however, earned $8.5 million, up from $8.3 million in 1979.) According to E. Ray Kemp, Dillard's vice chairman, 52% of the company's $35 million in sales in Arkansas are on credit, and "for every $1 we got back in interest and service charges, we spent $1.80" He adds, "Arkansas never was a normal place to do business, but now it's getting even worse.

Part of the problem, Mr. Kemp asserts, is that Arkansans are "taking advantage of any cheap credit they can get." He notes that Dillard's stores outside Arkansas average only 45% in charge sales, and those customers generally pay about 18% annual interest.

Over the years, Arkansas retailers have found a few ways to offset the costs of extending credit. Dillard's for example, has cut its pay period for credit purchases to six months from the 18 months allowed two years ago. Other retailers have quit extending their own credit altogether or encourage the use of bank credit cards, which can charge 15% in annual intrerest because of the federal bank laws.

Many retailers say they are operating with fewer clerks than ever before and have put off remodeling plans or moves to larger quarters. Others have simple trimmed inventories and discontinued free services.

HIGHER PRICES

However, the easiest way to recoup the built-in credit losses is to raise merchandise prices, and studies show that except in border areas, Arkansas retailers have done just that. According to Gene Lynch, professor of finance at the University of Arkansas in Fayetteville, prices for furniture and appliances in Little Rock run as much as 11% higher than prices for identical merchandise in surrounding states—a difference he blames solely on the usury ceiling. That finding indicates that "ci

customers are subsidizing every credit purchase in the state" by paying higher prices themselves, he contends. "There's no free lunch for anybody."

But in border towns such as Texarkana, which lies smack on the Texas-Arkansas line, Arkansas retailers can't raise prices and still compete with rivals across town. Consequently, most furniture and appliance dealers and all 15 franchised new-car dealers have set up shop on the Texas side of State Line Avenue, which bisects the central business district. There, they can charge up to 24% for consumer credit.

Melvin Kusin, ower of Kusin's Texas Furniture Store in Texarkana, knows what it's like to do business in both states because he owns another furniture store in nearby Hope, Ark. Mr. Kusin says the Texas store has "subsidized" the Hope store since consumer lending was "flat cut off" by Arkansas banks last summer. "Without the Texas store, we'd have to add 8% to 10% to our prices across the board just to cover interest expenses."

SOME OLD ESTABLISHMENTS

The few furniture dealers staying in Arkansas have been fixtures there for nearly half a century. "Sure we'd be better off in Texas, but we own our own property here," says R. J. McNatt, whose Moore Furniture Store has been in business "within spitin' distance of Texas" for more than 40 years. "Sometimes, when I get to thinking about it, I get a little mad that they don't have my problems down the street," adds the unperturbable Mr McNatt. "But it's too late to move now."

The new-car dealers in Texarkana are lucky that, by the early 1970, they all had moved to the Texas side. "Arkansas has practically been cut out of the map" as far as the auto makers' finance companies are concerned, says Dennis Jungmeyer, executive director of the Arkansas Automobile Dealers Association.

In the past year, General Motors Acceptance Corp., Ford Motor Credit Corp. and Chrysler Credit Corp.—all bound to the 10% interest ceiling for consumer car loans—have imposed on Arkansas dealers restrictions unheard of in the other 49 states. For example, GMAC and Ford Motor Credit don't extend wholesale or retail credit on new non-GM and non-Ford products, and GMAC finances the sale of a used car only in it is traded in on a new GM model. Unlike elsewhere, all dealers in Arkansas have to pay for insurance on cars in transit to their showrooms, and they have to pick up the full tab when a vehicle is repossessed. They also must pay market rates—as much as 23% lately—to finance their own inventories.

The Arkansas dealers, accustomed for years to tight financing, have still found ways to stay in business. Last year, only nine dealerships folded or changed hands out of 390, according to Mr. Jungmeyer. But so far this year, 17 dealers have already gone out of business or changed hands, even though sales have improved somewhat.

For a while, some dealers managed to turn the disadvantage of 10% credit into a marketing tool: They advertised their cheap credit to customers in surrounding states. But now some finance companies refuse to grant 10% credit to anyone but an Arkansas resident.

Normally, the dealers would rely on local banks to lend the money to customers turned down by finance companies. But even with the federal law allowing banks to charge 15%, they aren't making many auto loans. Several Little Rock banks say they grant consumer loans only to their best customers and only in amounts exceeding $3,000.

"With consumer loans, you have to be sparing and lend only to stay in touch with your good customers," says Mr. Bowen of Commercial National Bank. And Joseph Ford, a vice president at First National Bank in Little Rock, adds, "We just plain can't afford to loan out money" even at 15%. Since last June, Mr. Ford has seen First National's outstanding consumer loans drop to less than $13 million from $17 million. "This lack of credit has got to hurt the young people and little people of Arkansas as well as the businesses," he observes.

In the wake of failures at the ballot boxes, bankers, retailers and car dealers are beginning to hope for help from higher, and previously unmentionable, places. "Nobody likes the idea of the federal government meddling with our business," says David Kilborn, general manager of Cliff Peck Chevrolet in Little Rock. "But that's about our last hope now." Several Arkansas legislators in Washington have introduced a bill that would provide federal interest-rate relief to retailers, and a New York congressman has proposed creation of a national usury ceiling that would override state-imposed limits.

If retailers and auto dealers in Arkansas can hang on until November 1982, however, federal help may not be needed. In March, the Arkansas legislature voted to put on the 1982 ballot yet-another constitutional amendment that would raise the consumer-loan ceiling to 17%—which still would be the nation's lowest—while retaining the current penalty for violations.

But even the amendment's proponents aren't very optimistic that it will fare any better than the last three proposals. "It's pretty hard to convince a voter that 17% or 18% interest will end up costing him no more than the 10% he's paying now," Mr. Kemp of Dillard's says.

Others aren't sure that the proposed amendment will offer enough relief. "My worst fear is that the new amendment will be as obsolete as the old law by the time we get around to vote on it," says Jackson Stephens, chairman of Stephens Inc., a Little Rock investment banking firm. "But by that time," he adds, "things might be so bad that the people will demand a cure."

ARKANSAS VERSUS U.S. EMPLOYMENT CHANGES FOR SELECTED INDUSTRIES, 1979–80

Area of employment	Arkansas employment fourth quarter		Percent change 1979–80		Additional jobs in Arkansas with U.S. growth rate
	1979	1980	Arkansas	United States	
Transportation and public utilities	45,500	43,500	−4.4	0.0027	2,100
Wholesale trade	42,000	41,000	−2.4	.0148	1,800
Retail trade	123,400	124,500	.0089	.0149	1,800
Finance, insurance, and real estate	31,400	32,300	.0287	.0378	287
Total					5,987

Source: Employment Security Division, U.S. Department of Labor and Arkansas publications, and the Industrial Research and Extension Center, University of Arkansas.

ARMA

Arkansas Retail Merchants Association

University Tower, Suite 515 — University Avenue at 12th Street
Little Rock, Arkansas 72204 (501) [illegible]

July 9, 1981

Senate Sub-committee on Financial Institutions
United States Senate
Washington, D. C.

Dear Sir: Re S. 963

The Arkansas Retail Merchants Association is a statewide trade association whose members operate more than 2,000 retail stores in Arkansas. Approximately one-half of these stores make credit available to their customers. As a group, these stores are the state's principal source of credit for consumer commodities, because the banks long ago were forced to practically withdraw from the consumer credit field, due to the 10% Arkansas Usury ceiling.

It is on behalf of these credit-granting retailers, and their customers who are threatened with loss of access to credit, that we write this letter to your committee.

Arkansas retailers desperately need relief rom the crushing burden of having to borrow money at 21% interest, but only being allowed to collect 10% when they re-loan it, in the form of credit to their customers. They cannot afford much longer to absorb this loss, plus all the normal costs of operating a credit system.

This relief would be provided through passage of S. 963, sponsored by our two Arkansas Senators, Dale Bumpers and David Pryor.

More than a year ago the U. S. Congress responded to the pleas of Arkansas banks, savings institutions, and the Federal agri-credit agencies by pre-empting the Arkansas usury limit for these financial entities. The preemption measure established a ceiling 5 points above the Federal Discount rate for commercial and agricultural loans, one point above discount for consumer loans.

This preemption helped the financial institutions greatly, <u>but made the problem much worse for credit-granting retailers, auto dealers, and agricultural supply businesses.</u>

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Arkansas businesses are declaring bankruptcy at an unprecedented rate. In nearly every case, the Arkansas 10% usury ceiling is cited as one of the major factors causing the business to fail.

It is difficult to estimate the dollar loss occuring in the retail industry because of a ceiling on finance charges that permits the retailer to recover only about one half of his interest cost. But we have U. S. Department of Commerce figures indicating that the retail industry in Arkansas is an $8 billion industry. Roughly half of this annual sales volume involves credit. Receivables normally run 40% to 50% of annual credit sales, so a conservative estimate of the losses being absorbed by retailers would be $200,000,000!

In their efforts to contain these losses, retailers are being forced to restrain customer use of credit, shorten repayment periods, increase retail prices (hurting the cash customer) and in some cases, discontinue credit altogether.

There can be little argument with the retail industry's need for relief from this 10% ceiling in a time of 20% money rates.

The need for quick relief is equally important. Every day that passes represents close to a million dollar loss to the retail industry.

We urge the members of the Committee to give a favorable recommendation to S. 963, so that it may be enacted as quickly as possible.

Yours truly,

Glenn A. Black

Glenn A. Black
President

Senator TOWER. Thank you for your testimony. I view this matter with mixed emotions. My great-granddaddy shed his blood on the battlefield at Shiloh for States rights, and I don't take lightly to the idea of Federal preemption of State law, because I believe that we should and must reserve broad powers to the States. And of course we know that the usury laws were enacted for very good reason in our societies many years ago, and they had much validity then. I think we probably both remember a late colleague of ours who represented the district which joined your States rights, Patman, who of course thought bankers were the incarnation of the devil. [Laughter.]

Now, at one time they might have been. We certainly would not say that about them now. But in fact, the national marketplace is what it is and States must function in it.

I think you have indicated that actually the restraints on interest rates are included in your State constitution.

Senator BUMPERS. They are, Mr. Chairman.

Senator TOWER. What is the amending process?

Senator BUMPERS. The amending process is twofold, but the only one we've ever used there, to my knowledge, is where the legislature submits a resolution during its regular session. They are limited to three resolutions in any biennium and they submit the amendments to the people by voting.

Senator TOWER. This has not been submitted to a referrendum.

Senator BUMPERS. It has been.

Senator TOWER. It has been?

CONSTITUTIONAL AMENDMENT REFUSED

Senator BUMPERS. It has been, Mr. Chairman, and I don't want to delude, deceive, or distort in any way what has happened in Arkansas. The people have consistently refused to pass a constitutional amendment. It will be on the ballot again in November of 1982. I would say certainly that if we had not had this national override, Arkansas really would be a basket case right now because the banks there are not limited on the interest they can collect on money loaned out of State. So all they do, of course, is just send their money to the New York banks and they would fare very well, but there would be no money available for the local merchants or people.

But when you put an amendment on the ballot to raise the interest rates, the ordinary person is not going to take the time to educate himself to the economic figures I just gave a moment ago and he's going to vote no. And that's what's been happening. There is an incredibly difficult educational process. I don't like to have to do it, but Senator Pryor and I and the Governor at that time, Bill Clinton, last year took a very strong stand. You can see how much clout we have. We took a very strong stand in favor of that amendment and it was not easy to do that.

That was some baggage I'd just as soon not carry, because I was up for reelection myself. But I felt so strongly that it had to be done. I know Senator Pryor did, too.

Senator PRYOR. Mr. Chairman, may I mention that S.963 is basically a stopgap proposal? It's temporary. It sunsets in April of 1983. On our last vote on this issue, Mr. Chairman, in the fall of 1980, 44

percent of the people of the State voted to change our interest clause in the constitution. That is much closer than earlier votes and gives us some hope that the people of Arkansas are ready for a change.

But also, Mr. Chairman, just to show we are making some progress and that takes our people a little time to make a change: in the 1874 constitution there was a provision to limit the salaries of the Governor to $10,000 a year. From 1874 to 1977 the Governors of Arkansas were paid no more than $10,000 a year. And I have heard Senator Bumpers say on several occasions that when he received his first paycheck as Governor, he put that paycheck on the upstairs chest of drawers at the Governor's mansion. The upstairs maid found the check, thought it was hers, and quit. [Laughter.]

The reason for making that point is to let you know that the people decided to change that provision in the election of 1976, and I think, given a little more time, Mr. Chairman, they will see that the provision in our constitution limiting interest to 10 percent also should be changed.

Senator Bumpers. Mr. Chairman, on that salary incidentally, as soon as I left office it would certainly have been unbecoming of me to chair a committee to try to raise the Governor's salary and other constitutional offices. But the minute I left, and knowing that David was not a wealthy fellow and was going to have a tough time making it—he wasn't wealthy like me, anyway, so I chaired the committee to get a constitutional amendment on the ballot and we titled it an amendment to limit constitutional salaries, officers' salaries. And it passed 2 to 1.

If you can figure out a title like that for interest rates down there. [Laughter.]

Senator Tower. That was pretty clever. But as long as Rockefeller was Governor, he didn't need any salary at all.

Senator Pryor. He didn't even take his salary.

Senator Bumpers. I always said I sold my cattle to run against Governor Rockefeller. He didn't have to sell his, and I often wish I had mine back. [Laughter.]

SURCHARGES

Senator Tower. Now, of course, right now federally insured institutions are permitted to charge 1 percent over the discount rate. Your bill would permit all persons to charge 1 percent over the discount rate, inclusive of any surcharge. Now, with the surcharge at 4 percent, this makes a considerable difference as to the kind of relief it provides.

Is it your intent to include or to exclude the surcharge as part of the permissible alternative federal ceiling?

Senator Bumpers. Mr. Chairman, that's a very difficult question for me to answer. I have ambivalent feelings about that. Right now an automobile dealer, if he sells an automobile, has none of the protections that he used to have, the so-called 3–C protection. If he sells an automobile and the buyer is delinquent, he must make that payment for that buyer.

Now, that is a prescription for bankruptcy for automobile dealers. Right now GMAC is pretty much online. They are committed to giving them the same protection they used to have as long as

the discount rate is at 14 percent. So right now, 1 percent above the Federal discount rate would solve the automobile dealer's problem.

But if that discount rate comes back down, and certainly you and I both divinely hope it will, to 13 percent, than all bets are off and they go right back to that. So the surcharge, it may be possible part or all that surcharge will be necessary to make sure that this doesn't happen. But I will say that's an open question with me right now.

Senator TOWER. Well, let me follow that up with another question. The prime rate now is around 20 percent. In light of that fact, even with or without the surcharge, do you believe that your bill offers sufficient relief?

Senator BUMPERS. There again, as Senator Pryor said, I would be reluctant not to include a percentage or all of the surcharge, because I am afraid, Senator Tower, if we pass this bill, that next week, or might be three weeks from now, we'd have another bill asking you to include a surcharge. That's what worries me about it.

I don't like the idea of the surcharge, but I can see, if GMAC is willing to finance automobiles for 15 percent in Arkansas, which is a fairly low figure compared to the national percentages, than I would certainly want them to. By the same token, if the discount rate goes down and they throw this thing back on the dealer's lap, the way they probably would, then the dealers are going to get right back in the same kind of problem they are in right now.

Senator TOWER. I think my time has expired. Senator Dixon?

Senator DIXON. I have no questions.

Senator TOWER. Senator Lugar?

Senator LUGAR. Mr. Chairman, I first of all want to express personal appreciation to our colleagues for coming. Likewise, for their cooperation during the housing legislation, which comes under this committee. And at that time, both distinguished Senators from Arkansas indicated they had immediate concerns and were dissuaded from pursuing them at that moment, with the thought that this hearing would take place. I think this is an important issue, and, prompted by their concern, I moved ahead with additional legislation which is more comprehensive but which clearly tries to meet some of the concerns that the Senators from Arkansas have mentioned, as well as the whole gamut of additional ones that some of us on the committee have found.

I have no questions beyond those which you have raised, Mr. Chairman, or those that have been covered in the testimony. I am hopeful in these hearings we will face squarely the problems that prompted constituents of yours to come to you and certainly have brought an equal number of my constituents to me. I would simply pledge that I would like to work with you to make certain we come forward with good legislation.

Senator BUMPERS. Mr. Chairman, if I may just make one additional comment to what Senator Lugar has said. I want to thank him because he was on the floor the day I offered the amendment, generously offered to hold these hearings, and I appreciate that very much. And I want to say this, Senator Lugar. Your legislation would solve our problem.

Our concern is this, and I hope you won't think this is presumptuous. Our concern is the urgency of our problem because something like 10,000 automobile dealers have gone out of business since 1974. Over 100,000 people have lost their jobs nationally, and that's just going to be compounded in our State.

My point is, if there is any way to get this bill through, your legislation would preempt this. And if it's going to take some time for this committee to hold the hearings and mark your legislation up, which is much more comprehensive, of course, we would certainly hope that we could get our bill out in the meantime. If yours comes through later on, I promise you—I hate to just say carte blanche without supporting, but certainly even though it would preempt this, the urgency of this can't be overemphasized.

Senator LUGAR. I understand. Thank you.

Senator TOWER. Senator Dodd, do you have any questions?

Senator DODD. Well, Mr. Chairman, first of all, let me apologize for being a few minutes late. I have read the testimony of my two Senate colleagues, and I am aware of their particular interest and concern because of the situation in Arkansas. I don't know whether this has been asked, but there is the question of raising ceilings, setting ceilings in order to protect some lenders where there is no competition; whether or not you should have some sort of ceiling to see that they are guaranteed some insulation, some protection. Has that been raised?

Senator BUMPERS. Of course, I'm not sure I understand your question. Was it addressed to Senator Pryor on his testimony?

Senator DODD. On his testimony, but either one of you can respond to it. I said "lenders"; I meant "borrowers." In terms of the ceiling itself, should there be some ceiling? You've got 10 percent, is it, in Arkansas?

Senator PRYOR. We have a constitutional provision.

Senator DODD. That sets a 10-percent ceiling.

Senator PRYOR. It takes a vote of the people to change it.

Senator BUMPERS. Set in 1874, and it was a darn high provision then.

Senator PRYOR. We had an illuminating discussion on some of these provisions of the 1874 document earlier this morning. But I would just simply like to say that our legislation S. 963 is temporary, it sunsets, it does have an override provision, as does the other piece of legislation that we're considering here today, and we just hope that it will get favorable consideration.

Senator DODD. I realize that. I confused the question by saying "lenders." I meant "borrowers." That is the question of whether or not we should remove all ceilings, whether or not we give the States 3 years to respond. You come from such a stringent situation and yet there is the danger, obviously—we are all aware of it—of what happens to borrowers down the road. Where does this take us? What is the impact on inflation? Should there be a set ceiling? Should it be one that's tied to the Consumer Price Index or to—the Fed discount rate is what some of them have been tied to in the last couple of years.

Senator PRYOR. S. 963 is tied to the Federal discount rate—1 percent above—with the possibility of an additional 4-percent surcharge, which I am sure will be discussed by other witnesses who

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come before the committee. I think this floating rate provides the flexibility the market needs while giving borrowers reassurance that interest rates will not rise to unreasonable levels.

Senator DODD. I understand your bill is for 3 years, giving the States an opportunity to respond to that.

Senator BUMPERS. That's correct.

Senator DODD. What I am asking, I guess, and either of you can respond, is after that 3-year period, should we still proceed with some sort of linkage—Fed discount rate, CPI, whatever else it might be—to protect borrowers? Is it really wise just to lift it off entirely? Assuming some States, all States, whatever the percentage may be, don't respond in any way whatsoever, what happens? What potentially happens?

INCREASE 3-YEAR LIMITATION

Senator PRYOR. Our sunset date of April 1, 1983, will take us through the next referendum in Arkansas. The people of our State may, or may not, decide to make a change in our constitution, but Senator Bumpers and I feel that the most we can ask of the Congress is a temporary preemption simply to buy time for the people of our State to act. If the constitution is not amended, I suppose we will have to live with that decision.

S. 1406, on the other hand, would lift all ceilings permanently unless the States acted within 3 years to reimpose their own laws. It is my personal preference that we not have a 3-year limitation on the preemption by the States. I believe that the States should be given the opportunity—say, 10 years from now, if they wish—to preempt the Federal legislation. That may be wishful thinking, but I know that this is a concern of many people who wish to preserve, wherever possible, the rights of the States to enact their own laws.

Senator BUMPERS. Chris, I think maybe I understand the question a little better now. In April of 1983 all of this legislation, including some of the usury override provisions of the omnibus banking bill that we passed last year, self-destructs and everybody is back to square 1 then. And the bill that Senator Pryor and I are offering here today does the same thing. In other words, we're strapped with this 10-percent constitutional limitation on interest.

In April of 1983, unless something has happened in between, we go right back to that. As long as this bill is in effect, of course, it's at 1 percent above the Federal discount rate. But in April the whole thing self-destructs, as does the usury override for agricultural and business loans in the omnibus banking bill.

I might make one other point I didn't make to the full committee during the testimony a moment ago, and that is, according to a National study a little over a year ago, 30 percent of the automobile sales were being lost for lack of financing. Today that figure is 50 percent. In other words, automobile dealers would be selling close to 50 percent more automobiles today than they are selling if they could get financing.

It's just a terrible situation, when you consider the depressed state of the automobile industry and I don't want everybody to think this is the only reason for this bill. Every retailer in our State who has to finance anything from refrigerators on up, unless it's farm equipment or something being used for business purposes,

which we included in the omnibus banking bill last year. But GMAC takes the position, and I think GECC does, too, that anything you sell is going to be for personal reasons because they don't want to face the possibility of a lawsuit.

A fellow comes in and says, "I'm a travelling salesman. I want to buy a new car. It's going to be used for business purposes, so you can charge me whatever interest rate you want to." It's my understanding GMAC says they will not take that risk of charging him 5 percent above the discount rate. But they don't do that, for fear he'll come back later and reneg on what he said at that time, and say this was really a personal automobile and you've overcharged me, it's usurious, et cetera.

Senator DODD. One last point. I'm just curious, you may have touched on it. What are the politics in Arkansas on this?

Senator BUMPERS. It ain't very happy for me and Senator Pryor to be here to ask for higher interest rates.

Senator TOWER. We did have a little discussion on that, Senator. It might be painful for them to have to repeat it.

Senator DODD. If it's already been asked, I'll find out afterwards.

Constitutionally we have two-thirds requirements to change the legislature, two thirds?

Senator PRYOR. The State legislature refers three amendments or resolutions each 2 years. It cannot refer any resolutions in a special session, only in a general. We have voted on this matter several times, most recently in November of 1980. At that time 44 percent of the people in the State said they prefered a change to a floating rate; the balance, or the majority, said not. We hope to have this on the ballot again in the fall of 1982, but now we must ask for some temporary relief for our retailers, car dealers, those who floorplan, because they are in a calamitous situation right now that is actually going to lead to a financial crash in the retail market in Arkansas.

Senator BUMPERS. Senator Dodd, you didn't serve with Senator Morgan in this body. Senator Morgan was probably the most ardent champion of States' rights in setting their own interest rates. Senator Pryor and I were very close friends of his, but we couldn't persuade him to support any of this legislation because he felt so strongly about it.

I must say, the chairman, Senator Tower, said at the opening of this that his great-grandfather fought at Shiloh and he was a great champion of States' rights, and I am, too. This ought to be settled at the local level. We ought not to be here having to do this, and I certainly hope that it will be settled. Either we will have a national, preemptive rate that everybody will live with, or ever State will live with whatever the consequences are.

But you know, when you have good friends who are retailers, and I was a retailer, and I know I had a half million dollars' worth of paper out when I sold my business. I wouldn't be in business today under these circumstances. I would just to have had to sell my merchandise out the front door and forgotten it, and that's what people in Arkansas are doing. You can't neglect that. You cannot ignore, no matter how deplorable you find these interest rates, you can't sit back and see your friends just going broke because of a situation over which they have no control.

Senator DODD. Thank you, Mr. Chairman.

Senator TOWER. Any further questions, Senator Lugar?

Senator LUGAR. I would just like to follow up the colloquy between my colleagues, Senator Dodd and Senator Bumpers, because clearly this committee did have a lot of responsibility in the Senate, of course, as a whole for thinking through the restructuring, refinancing of the Chrysler Corp. The automobile situation is not unknown to this committee and we struggled mightily with that situation.

The predicament that we have here is clearly underlined—I don't know whether 30 percent or 50 percent of sales in this country are being postponed because of credit, but it is a very large number going into hundreds of thousands of automobiles on a national basis, not only in the State of Arkansas but the State of Indiana and everywhere else, for that matter. So on the one hand we have taken on a public responsibility of asking the taxpayers of the country to underwrite loans to Chrysler, and on the other we have pretty well shut off the possibilities not only for Chrysler but General Motors, Ford, and everybody else who is selling cars in the country, and it simply has got to be squared in some fashion, given the vagaries of what is going on in our economy.

So I appreciate, especially, your bringing this point to the fore, because the politics of this situation is very confused. I would guess, I think, without contradiction from anyone, that the UAW would be very strongly in favor of automobile sales in the country at the present, accelerating them in every possible way, and so would those who are stockholders, and so, as a matter of fact, would everybody else in the Senate who voted for Chrysler legislation or is at all interested in this problem, or recreational vehicles or for that matter, in refrigerators or anything else which at present is not being sold in the country, and try to get something going. So I appreciate the points that you made.

Senator TOWER. Thank you very much for your useful testimony this morning.

Our next witness is Congressman John J. LaFalce, from the State of New York.

Congressman, first, may I defer to my colleague from Indiana, Senator Lugar, and see if he wants to make an opening statement.

Senator LUGAR. Mr. Chairman, I ask unanimous consent that my opening statement be made a part of the record. It simply states that several weeks ago, I introduced S. 1406, and that will be a subject of discussion. And the very articulate Congressman who is about to testify, as a matter of fact, has offered identical legislation, more or less, on the House of Representatives, and I will allow him to be a spokesman for both of us at this point.

Senator TOWER. Your statement will be entered in the record as though read.

[The complete statement follows:]

OPENING STATEMENT OF SENATOR LUGAR

Senator LUGAR. Several weeks ago, I introduced S. 1406, the Credit Deregulation and Availability Act of 1981. This bill preempts State interest rate ceilings on consumer, agricultural, and business credit and eliminates the Federal ceiling on the rate of

interest that may be charged by Federal credit unions. Today, we begin hearings on this bill, as well as a more limited preemption bill, S. 963, which was introduced earlier by Senators Bumpers and Pryor. Substantial testimony has been received already by the full Senate Banking Committee on this issue during the extensive oversight hearings on financial industry issues earlier this year.

I believe that broad usury preemption legislation is both timely and important. consumers and industries nationwide are being severely damaged by the limited availability of credit that has resulted from consumer credit interest rate ceilings.

Industries critical to the well-being of Indiana, such as the automobile and recreational vehicle manufacturers, are finding their businesses stagnating because of the inability of consumers in other States to obtain financing. Other industries, particularly the manufacturers and sellers of big ticket items, are unable to market their products because of the lack of available financing.

Consumers are also being injured. Those who desire to purchase these products simply cannot get credit, even if they are willing and qualified to pay higher interest rates.

The realities of the marketplace simply do not permit restrictive interest rate ceilings. Interest rate ceilings tend to distort financial markets and depress the economy—they are counterproductive in competitive markets. When manufacturers are unable to market their product because of restrictive interest rate ceilings, reform is warranted. When this situation cuts across State lines, national legislation to free up the market for consumer credit transactions must be forthcoming.

The Depository Institution Deregulation Act of last year provided for the phase out of interest rate ceilings on deposit accounts, eventually resulting in the complete decontrol of depository institution's liabilities.

Financial institutions will be unable to pay market rates on their deposits if they are not permitted to charge market rates for credit.

The Deregulation Act began the process of deregulating interest rate ceilings on credit by preempting State ceilings on first mortgages and establishing an alternative, temporary Federal ceiling for business and agricultural credit. It is time for the Congress to complete this process begun last year by enacting S. 1406.

I am confident that the testimony presented at these hearings today will substantiate the need for this bill.

Senator TOWER. Congressman LaFalce, we're delighted to have you here this morning. We would be glad to print your entire statement in the record, and permit you to summarize it, if you wish to do so.

You may proceed in any way that you see fit.

STATEMENT OF JOHN J. LaFALCE, REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. LAFALCE. Thank you very much for asking me to appear before you this morning. I would like to do precisely that. I'd like to introduce the entire testimony that I prepared, and speak off the cuff, and hopefully be mercifully brief, so you can listen to experts rather than politicians.

I come here as a liberal Democrat, favoring legislation that some people think is strictly probanker legislation. It's hardly that at all. I'm also chairman of the House Small Business Subcommittee, and General Oversight Committee. I just want to make a few points.

DISCRIMINATING AGAINST THE CONSUMER

The Federal Government has preempted usury ceiling after usury ceiling. When it comes to residential mortgages, the Federal Government preempted the usury ceilings on those. When it came to certain business loans, the Federal Government preempted usury ceilings on those. The only one that we really haven't, the main one we haven't preempted, is the usury ceiling for the consumer, and I don't think we should discriminate against the consumer.

In discriminating against the consumer, we adversely impact the consumer, because he's not able to get a loan when the usury ceiling is so low that it doesn't bear any relationship to market interest rates. That, in turn, discriminates against the small businessman, because the small businessman is not having his goods or services purchased by the consumer.

And in so far as the banking community is concerned, they're not really hurt, because they're not giving loans out in the first place at a loss, because it just wouldn't make sense to give out loans when money costs you 15, 20, 25 percent—whatever the conditions are—and you can only charge 10 or 12 percent.

Now, the reason this came to my attention so forcefully is also because I'm from New York State, and New York State had a usury law. Back in 1980, we couldn't charge more than about 12 percent. And yet, as you well know, the interest rates varied from around 20 percent or so, on down. But for most of 1980, in order to buy a car in the State of New York for $6,000, you had to come up with a down payment of $6,000. Prior to the passage in March of our Depository Institutions Deregulation Act, if you wanted to buy a home for $100,000, your down payment had to be $100,000.

The point is, loans simply weren't being given. In some theoretical world, maybe we should say: "OK. We've got to give total deference to the States on this."

However, there are a number of arguments that I think militate against that. First of all, it's not been the historic tradition of the U.S. Congress to just give total deference. We have preempted in instance after instance, and there's no reason why we shouldn't preempt in this instance.

Second, there is a way for the Federal Government to act, and still give a certain amount of deference to the State governments. That's to permit a certain period of time—whether it be 2 years or so—after the effective date of Federal legislation, or whether it be 3 years, in which the State can act to go back to its old way, or to impose some new type of usury ceiling.

Third, if we're really going to look at the market that exists in the United States today, the interest rates are really determined by national and international factors. They are not determined at all by State factors. And so, if we want to pass legislation on the basis of economic sense, we really ought to have a national usury rate or a Federal preemption.

Senator Dodd asked the question of Senators Bumpers and Pryor: Well, shouldn't we peg it to something, in order to protect the consumer?

That's a very good question. I gave consideration to that last year, when I first introduced the straight Federal preemption. Then I thought, well, let's come in with some type of—not just a Federal preemption, but a Federal ceiling. The difficulty is, we open up a Pandora's box there.

What do you tie that Federal ceiling to? I don't think tying it to the Federal discount rate makes any sense at all.

Do you tie it to 2-year certificates? Three years? There are just a million and one different ways that you could establish a Federal usury ceiling. And I'm not sure that there's any good way, though, out of all of those.

Most importantly, I don't think it's necessary. If we look to the origin of usury ceilings—I don't think Arkansas, for example, which was 10 percent, is low in the entire United States of America. That 10 percent was established when we had about 2- or 3-percent interest rates. If we were to have comparable usury ceilings today, when the prime is about 20.5 percent, we'd need about a 50-percent usury ceiling; and of course, nobody's going to pass that.

DANGER IN FEDERAL USURY CEILINGS

There's always the great danger, too, whenever we get involved in Federal usury ceilings, as opposed to straight preemptions, that we're so tempted to bring it down as close as possible to the prevailing prime rate or something, that we're not only not going to achieve the objective that we intended; we are going to perhaps be asking for trouble in a year or two, when the interest rates could go up, rather than down.

But also, we are going to be—if we establish that usury ceiling—so close to what is truly profitable, we are going to be encouraging the financial institution community to set their ceilings at that, rather than truly let competitive market forces work, too. That's another point that must be mentioned.

Today in the year 1981, as opposed to the Biblical days, and as opposed to 100 years ago or 50 years ago in the United States, you know, when usury ceilings were adopted— we have opened competition. We have many sources to go to for money. We do have a classical free enterprise system when it comes to obtaining money in the United States today.

Those are basically the points I want to make. There are very few differences between the legislation I introduced this year and that that Senator Lugar introduced. I think if we're going to act, that we ought to act quickly.

There are a number of States—I'm not sure exactly how many; I think it's about 16 right now—that do have restrictive usury laws which are, in effect, closing out the consumer from getting any credit whatsoever. And it's hurting the small business community; it's hurting the large business community, too. And there's really just no reason for it. It's not a question of getting a loan at 10 percent or getting a loan at 20 percent; it's a question of getting no loan, or getting a loan at market interest rates.

We're not forcing a loan at 20 percent upon any individual at all. He has total discretion to obtain the loan at that interest rate, or no loan. And of course, we're not in any way affecting the truth in lending requirements at all. He still has all the protections available to him—that is, all the disclosure protections, knowing exactly what he or she is getting into.

Also, both Senator Lugar's bill and mine in no way affect the State consumer protection laws. Any consumer protection laws on the books in any given State are totally protected, both by Senator Lugar's bill and by mine. The only thing we would do would be to preempt the usury ceilings.

If we're going to have action, I think we need fast action. If we're going to get fast action, I think it's going to have to emanate from the U.S. Senate. Once the Senate acts, I think the House of Representatives will then act, or will accept it in conference, as we accepted so many of the usury ceiling preemptions in conference, on the Depository Institutions Deregulation Act, that we might never have been able to get through ab initio in the House of Representatives.

Also, Secretary Regan has come out in strong support of usury preemption, in his testimony before this committee.

Senator TOWER. Would you yield at that point, for a minute?

You mentioned action in the House. Have any hearings been held or scheduled in the House, on this issue?

Mr. LAFALCE. The Subcommittee on Financial Institutions, Mr. Chairman, has not held one hearing on any issue at all, in the year 1981. And so, the answer is no. They haven't on usury. But you have to understand it in context.

However, I also point out that the Subcommittee on Financial Institutions, and the full Banking Committee, are beginning hearings at the end of July, on a myriad of issues affecting the economy of the United States of America, and that certainly will include usury ceilings.

Senator TOWER. Thank you very much, Congresman.

It's interesting to note that you are the lead sponsor for this legislation in the House, given the fact that New York law was recently altered regarding ceilings for consumer credit.

Mr. LAFALCE. When I first introduced it, Mr. Chairman, New York of course had a restrictive usury, but then I became so intellectually convinced of the merits of the issue—as opposed to looking out just for the interests of New York State—that I convinced—I said: "Somebody has to carry the banner for the other States that have restrictive using ceilings." And since I started it, I might as well try to finish it.

PIECEMEAL APPROACH TO DEREGULATION

Senator TOWER. You point out that interest rate deregulation has, up to now, been approached pretty much on a piecemeal basis.

Would you care to comment on the problems of the piecemeal approach to this particular issue?

Mr. LAFALCE. Well, there are two ways in which piecemeal approach is a problem. First of all, if you approach it on the problem from State to State, that businessman who wants to operate not just in one State but in many States, is at a serious disadvantage,

because that businessman might have to comply with the laws of five different States. And that becomes terribly confusing. So that's one problem.

In so far as the piecemeal approach is concerned, I don't know that there is any rational basis for preempting loans, if it's a business loan—having Federal preemption for residential mortgages, and then effectively not having Federal preemption for consumer loans. You hurt not only the consumer, but you also of course, more seriously, hurt the small businessman, who can't sell to the consumer because the consumer doesn't have funds available to him.

For the consumer, it's a question of the consumer getting a new car or not getting a new car. He can probably do without the new car. He can fix up his 1974 Chevrolet, rather than buy a 1981 Chevrolet. It is going to have an adverse effect on the economy, to be sure. But when you multiply that one consumer times 500 or 1,000, you're putting that automobile dealer and all his employees out of business.

So, it is a definite inconvenience, and it is definite discimination against the consumer, foreclosing an option to him. But it is a disaster to the small businessman.

Senator TOWER. Congressman, I think my time is about up. I have two or three additional questions that I would like to submit to you to respond at a later date, if you will.

Mr. LAFALCE. Surely.

[Complete statement of Congressman LaFalce follows:]

Statement of Rep. John J. LaFalce of New York before Financial Institutions Subcommittee of Senate Banking Committee, July 9, 1981 on the Credit Deregulation and Availability Act of 1981.

Mr. Chairman, I want to thank you for the opportunity to appear before the Senate Banking Committee's Financial Institutions Subcommittee.

I am glad that this Subcommittee is holding hearings on legislation that addresses a problem that seriously affects both lenders and consumers -- usury ceilings on consumer loans. It is a problem that demands Congressional action because of the economic hardships it creates for consumers, retailers, and financial institutions. If there is one message I wish to leave with the Subcommittee this morning, it is that prompt action must be taken to provide lasting relief from artificial interest constraints that skew the consumer credit market.

The problem is simply stated. Many states currently have usury laws that set ceilings on consumer loans at levels below market interest rates. The result is that many banks, savings and loan associations, finance companies, retailers, and automobile dealers are reluctant to finance big-ticket items and extend revolving credit because of the high cost of their funds-- a cost that low usury ceilings prevent them from recouping. Moreover, this hurts not just consumers who cannot secure credit, but all consumers who end up paying higher prices to subsidize low interest rates caused by low usury ceilings. It is axiomatic that lenders

will raise prices in other areas to recover indirectly the credit costs they can't recover directly.

Usury ceilings and their debilitating economic consequences have long concerned me. I became actively involved in trying to resolve this problem last year when New York state was laboring under most restrictive usury limits, and it didn't appear that the state legislature would provide a remedy.

Constructive action was called for. In that spirit, I introduced legislation last year that provided for Federal preemption of state usury ceilings on consumer credit and also allowed lenders to charge market rates on open end credit plans, including credit cards. The cries for help that I heard from New York state bankers and businessmen were heeded by the New York legislature which met in emergency session last November to lift the state's usury ceilings.

But we still have many states where usury ceilings on consumer credit remain low and where the government is reluctant to deal with the problem.

The problem is nationwide in scope. Yet, interest rate deregulation has thus far been approached only on a piecemeal basis. The Federal government has acted in certain areas, but not in others; it has preempted state usury ceilings on certain types of lending, but not others. In those lending sectors that remain under state jurisdiction, interest rates vary from one state to another. What we have is a crazy quilt-work pattern that is

inherently irrational. It is now time to resolve the issue of interest rates on consumer loans on a national basis and adopt a uniform policy of Federal preemption of usury ceilings.

The need to achieve a national solution prompted me to introduce legislaton four months ago to provide for a simple Federal preemption of state usury ceilings on consumer loans. I was very pleased when Senator Lugar last month introduced a similar measure. While the bills have a few technical differences, they are essentially companion measures that rely on competitive market forces to set interest rates and be the ultimate regulator.

The bills neither affect the consumer protection provisions that the states and the Federal government have enacted nor restrict their power to act in this area in the future. This should meet the concerns of consumer groups which fear that Federal preemption might undermine consumer protections.

The bills also protect state prerogatives by allowing the states a 3-year period after the measure's enactment in which they could reimpose interest ceilings on consumer loans.

What is important is that both bills represent a serious effort to settle this problem once and for all. The validity of their approach has been demonstrated by New York State's experience since the deregulation last November of interest rate ceilings on consumer credit. I realize that there are fears that interest rates charged on consumer loans could skyrocket without usury ceilings. But a report issued last March by Muriel Siebert, the state Superintendent

of Banks, showed that did not happen. Interest rates for consumer credit rose as expected from their artificially low levels. But most financial institutions raised their charges to between 16 and 19 percent, well within the range the market was charging. This rise was accompanied by an increase in the amount of consumer credit available, the report said, and an increase in credit lines for individuals. Consumers at last had an opportunity not only to receive credit but to shop for credit.

As this Subcommittee considers this problem, it is important to remember that the legislation Senator Lugar and I have introduced reflects an almost universal consensus among the finance and retail communities and the Administration. Treasury Secretary Regan gave the Administration's strong endorsement to these efforts during his recent appearance before the Senate Banking Committee.

I know from the many letters I have received from small businesses throughout the nation that they expect Congress to pass legislation giving them relief from low usury ceilings.

Moreover, I am convinced, from all the calls and inquiries I have received from other Members of both the House and Senate, that there is a growing awareness in Congress of the scope and magnitude of this problem and the need to enact legislation to remedy it.

The time is right to resolve this problem. I hope we take that opportunity soon.

Thank you.

Senator TOWER. Senator Dixon?

Senator DIXON. I have no questions, Mr. Chairman.

Senator TOWER. Senator Lugar?

Senator LUGAR. Mr. Chairman, I would like to ask Congressman LaFalce: Is it not true that one problem of the piecemeal situation—you have touched upon this, but just to clarify the record—is that if in fact usury ceilings apply to automobiles, and they do not apply to houses or to commercial loans, that credit is likely to be extended to commerce and to housing?

Mr. LAFALCE. You really are engaging in credit allocation when you act in one area and not in another. And for opponents of the concept of governmental intervention in the marketplace, don't be mislead when we give relief on one hand and not on the other. We are intervening, we are allocating credit, most definitely.

Senator LUGAR. And this particular intervention—the Federal Government has intervened against consumers?

Mr. LAFALCE. Yes. And I think unwittingly, I think unwittingly. I don't think that reflection was given to this issue at the time, for example, of the passage of the Depository Institutions Deregulation Act.

Senator LUGAR. I would agree. But even though it was an unwitting discrimination against consumers, the remedy is at hand. And that is to put consumer finance back on a par with mortgage lending, commercial finance, and various other situations.

Mr. LAFALCE. Right. We're not mandating that consumers pay 25 or 20 percent interest rates. Because when the interest rates come down, he's not going to be paying 20; he's going to be paying whatever the market rate is. And there's plenty of competition out there.

New York has done a study, by the way. The superintendent of banking, Muriel Siebert, did a study of the effect of lifting the usury ceiling in the State of New York, and the results of that study show there's more credit than there ever was, and there's more competition than there ever was in New York.

Senator LUGAR. Would you be willing to make that study a part of the record?

Mr. LAFALCE. I would like to do that very much.

[The document is reprinted as follows:]

New York State BANKING DEPARTMENT

NEWS RELEASE

For Release:

Wednesday
March 4, 1981

Muriel Siebert • Superintendent • Two World Trade Center • New York, N.Y. 10047 • Phone (212) 488-2316

**BANKING SUPERINTENDENT RELEASES REPORT
ON CONSUMER CREDIT RATES AND CHARGES
AND ON DEREGULATION OF CERTAIN INTEREST RATES**

Muriel Siebert, New York State Superintendent of Banks, today released the Banking Department's report on its survey of interest rates and charges on consumer credit. The survey was conducted in order to develop information on the initial experience of deregulation of consumer credit interest rates under the Omnibus Banking Bill.

Superintendent Siebert indicated that there were three major findings evident from the survey:

1. The deregulation of interest rates on consumer credit has resulted in an increase in those rates at financial institutions and automobile dealers. This was to be expected since the previously existing level of interest rate ceilings was unrealistically low and led to a drying up in the availability of consumer credit for New Yorkers during much of last year.

2. There has been an increase in the availability of consumer credit as a number of financial institutions which had previously placed limits on their consumer lending have actively re-entered the market, liberalized their credit standards and raised their credit line limits. There was also some indication from automobile dealers of increased availability of financing for the average consu

3. Lenders are charging a wide range of interest rates and fees, thereby providing consumers with alternative choices which they can take advantage of by shopping for credit. Substantial variations in rates and fees on consumer loans were evident at banks in New York City and in each of the major metropolitan areas upstate: Albany, Utica, Syracuse, Rochester and Buffalo.

Superintendent Siebert also stated that since passage of the Omnibus Banking Bill, the Banking Department has embarked on a campaign to educate the public about the new law and to urge that

people shop for credit. As part of this campaign, the Department developed a brochure called "Shopping for Credit - A Consumer Guide for Credit in New York State", of which more than 3 1/2 million copies have been distributed.

In addition, through the assistance of the Outdoor Advertising Association of New York State, free billboard space has been provided throughout the State with messages urging consumers to shop for credit and announcing release of the Department's brochure. The savings banks and commercial banks industries have joined the outdoor advertising campaign by preparing billboard posters, with free billboard space once again being made available through the efforts of the Outdoor Advertising Association, with the theme that consumers should shop for credit.

Moreover, the New York City Transit Authority, as a public service, is providing free advertising space on subway cars for a three-month period, with the same theme as the billboards.

The Banking Department has also submitted a report to the Legislature recommending further deregulation of specific interest rate provisions in State law and other conforming amendments pursuant to the action taken in the Omnibus Banking Bill.

The full text of both reports is attached.

* * *

REPORT

ON SURVEY OF INTEREST RATES AND CHARGES

ON CONSUMER CREDIT

I. INTRODUCTION

In order to develop information on the initial experience with deregulation under the Omnibus Banking Bill, the Banking Department has undertaken a survey of financial institutions and others who extend credit to consumers. This survey was conducted in early January, 1981 when questionnaires were sent to both State and federally chartered financial institutions in New York State. The findings of this Report are based upon the responses received from commercial banks, savings banks, savings and loan associations and licensed lenders. In addition, questionnaires were sent to a sample of retail stores and automobile dealers throughout the State. Responses were received from well over half of the financial institutions but a much lower proportion of car dealers and retailers (Table 1). Among the banking institutions, a higher rate of response was received from those under State charter than those under federal charter.

The questionnaires requested information on the "most common" interest rate or finance charge to new borrowers or new customers for various types of credit. The "most common" rate or charge was defined as that charged on the largest dollar volume of new loans made in that particular category on the dates indicated on the questionnaire form. In the case of credit cards and other types of revolving credit, data on annual fees or other charges were sought. The institutions and firms surveyed were also asked to indicate whether the rates, charges and fees were the same at all their offices or places of business in New York State and whether

New York State Banking Department

February 1981

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TABLE 1

NUMBER OF QUESTIONNAIRES SENT OUT
AND RESPONSES RECEIVED

	Number of Questionnaires Sent Out	Number of Responses Received
Commercial Banks	223	135
Savings Banks	112	97
Savings & Loan Associations	116	73
Licensed Lenders	36	23
Automobile Dealers	281	83
Retail Stores:		
- Selected New York City Furniture Stores	31	1
- Other Retailers	81	16
Total	880	428

they were the same for all customers regardless of whether the applicant had an established relationship with the institution or firm.

Information for three dates was called for by the questionnaire: November 28, 1980, just prior to the effective date of the new law; December 1, 1980, the effective date of the new law; and January 2, 1981.

In order to update the findings, a telephone survey was made during February of a sample of financial institutions, retail stores and car dealers. This phone survey requested current interest rates, charges and fees on various types of consumer loans as well as announcements of planned changes. Information was also sought as to whether there had been any changes in policy regarding the availability of consumer credit relative to its availability last year before the usury ceilings were eliminated; whether there had been any changes in the volume of consumer loans made; and whether the imposition, or announcements of imposition, of higher rates or annual fees on bank credit cards had led to a substantial shift of credit card customers. In addition, Banking Department examiners were sent to a sample of furniture dealers in New York City during February to obtain current information on the charges they levied for credit purchases.

II. SUMMARY OF MAJOR FINDINGS

There are three major findings evident from the survey, the details of which are discussed in Section III. The first is that the deregulation of interest rates on consumer credit has resulted in an increase in those rates at financial institutions. This, of course, was to be expected in light of the fact that the previously existing level of interest rate ceilings was unrealistically low relative to market interest rates, to the cost of deposits and to inflationary increases in other operating expenses. This had brought about a drying up in the availability of consumer credit for New Yorkers during much of last year. Rates charged by automobile dealers also increased while retail stores presented a mixed picture with a few large retailers announcing rate increases although most respondents have not yet announced any changes.

The second major finding is that there has been an increase in the availability of consumer credit for New Yorkers. A number of banks and licensed lenders which previously had placed limits on their consumer lending have actively re-entered the market, liberalized their credit standards or raised their credit line limits. Some banks have increased their advertising for consumer loans and some have reported increases in the volume of consumer loans made although others reported no changes or declines due to such factors as the level of rates and the state of the economy. There is also some indication from automobile dealers of an increase in the availability of financing for the average consumer.

The third major finding is that banks are offering a wide range

of rates and fees, thereby providing consumers with alternative choices which they can take advantage of by shopping for credit. This is best illustrated by the results of the telephone survey made in mid-February of a sample of large commercial banks in New York City and upstate (Tables 2 and 3).

In New York City, for example, the current rate structure on consumer loans, including rates and fees publicly announced by the banks but which in most instances will not go into effect until some time in March, is the following:

- On conventional home improvement loans, different banks are charging rates of 16.25%, 17%, 18%, 19% and 20%.
- On new car loans, the available rates are 16%, 17%, 18% and 19%; on used car loans, 16.75%, 17%, 18% and 19%.
- On loans secured by savings or time accounts, the rates are 10.27%, 12%, 16%, 17%, 18%, 18.25% and 19%.*
- On overdraft checking loans, the rates available are 12%, 16%, 17% and 18%; on other unsecured personal loans, 18%, 18.25%, 19% and 20%.
- On credit cards, the prevailing rate is 18% although rates of 19% and 19.8% are also being charged. The bank charging the 19% rate does not impose any annual fees, but does have a 25¢ per item charge on cash advances; the bank charging 19.8% has an annual fee of $15 but no "per item" charges; some of the banks with the 18% rate have a $15 fee and a "per item" charge while others have no such fees or charges; and one bank's fee is $15 but will charge $12 per card for holders of both Visa and MasterCard.

There are also indications that some of those banks that have imposed fees on their credit cards have experienced losses of customers, while several of the banks offering cards without fees are being flooded with new applications.

Substantial variation in rates is also evident in the major

*Many of the commercial banks, both in New York City and upstate, reported the rates for regular installment loans collateralized by savings or time accounts.

TABLE 2

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED COMMERCIAL BANKS
IN NEW YORK STATE
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
New York City Banks			
Citibank, N.A.	19.00%	18.00%	18-19.00%**
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00***
Manufacturers Hanover Trust Company	19.00	17.00	17.00
Chemical Bank	17.00	17.00	17.00
Bankers Trust Company	19.00	18.00	19.00
Irving Trust Company	18.00	18.00	18.00
Bank of New York	19.00	17.00	19.00
European American Bank & Trust Company	18.00	16.00	18.00
National Bank of North America	20.00	19.00	19.00
Republic National Bank	19.00	18.00	18.00
Upstate Banks			
State Bank of Albany	18.00	18.00	18.00
Bankers Trust Company of Albany, N.A.	18.00	16.50	18.00
Oneida National Bank & Trust Company (Utica)	16.00	15.78	17.63
Key Bank of Central New York (Syracuse)	16.00	16.00	16.00
Lincoln First Bank, N.A. (Rochester)	18.00	17.00	18.00
Central Trust Company of Rochester	17.50	17.50	17.50
Marine Midland Bank, N.A. (Buffalo)	18.00	18.00	18.00
Manufacturers & Traders Trust Company (Buffalo)	19.13	19.60	19.60
Liberty National Bank & Trust Company (Buffalo)	18.00	18.00	18.00

*This Table includes changes in rates announced by mid-February but which will not be effective until later, generally during March.

**For cars less than 2 years old, the rate is 18%; for cars more than two years old, 19%.

***For cars less than 2 years old, the rate is 16.75%; for cars more than two years years old, 18.00%.

TABLE 2 (Concluded)

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED COMMERCIAL BANKS
IN NEW YORK STATE
February 1981*

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
New York City Banks				
Citibank N.A.	18.00%	--	--	19.00%
Chase Manhattan Bank, N.A.	18.25	9.00%	--	18.25
Manufactures Hanover Trust Company	19.00	9.00	17.00	19.00
Chemical Bank	12.00	9.00	9.00	19.00
Bankers Trust Company	17.00	--	7.00	19.00
Irving Trust Company	18.00	7.00	7.00	19.00
Bank of New York	17.00	9.00	--	19.00
European American Bank & Trust Company	10.27	7.00	--	16.00
National Bank of North America	16.00	9.00	--	20.00
Republic National Bank	19.00	--	--	19.00
Upstate Banks				
State Bank of Albany	18.00	9.00	18.00	18.00
Bankers Trust Company of Albany, N.A.	16.00	9.00	--	17.00
Oneida National Bank & Trust Company (Utica)	13.00	9.00	--	18.00
Key Bank of Central New York (Syracuse)	18.00	9.00	--	18.00
Lincoln First Bank, N.A. (Rochester)	17.00	9.00	--	18.50
Central Trust Company of Rochester	--	9.00	--	18.50
Marine Midland Bank, N.A. (Buffalo)	17.00	9.00	18.00	18.00
Manufacturers & Traders Trust Company (Buffalo)	19.60	9.00	--	19.60
Liberty National Bank & Trust Company (Buffalo)	18.00	9.00	18.00	18.00

*This Table includes changes in rates announced by mid-February but which will not be effective until later, generally during March.

TABLE 3

ANNUAL PERCENTAGE RATES
ON CREDIT CARDS AND OVERDRAFT LOANS
SELECTED COMMERCIAL BANKS
IN NEW YORK STATE
February 1981*

	Credit Card				Overdraft
	Purchases	Cash Advances	Annual Fees	Other Charges	Checking Loans
New York City Banks					
Citibank, N.A.	19.80%	19.80%	$15	None	18.00%
Chase Manhattan Bank, N.A.	18.00	18.00	15	25¢ per item	17.00
Manufacturers Hanover Trust Company	18.00	18.00	15	None	18.00
Chemical Bank	18.00	18.00	15-12**	25¢ per item	18.00
Bankers Trust Company	18.00	18.00	15	25¢ per item	12.00
Irving Trust Company	18.00/12.00***	12.00	None	None	18.00
Bank of New York	18.00	18.00	None	None	18.00
European American Bank & Trust Company	18.00	18.00	None	25¢ per item	16.00
National Bank of North America	19.00	19.00	None	None	18.00
Republic National Bank	--	--	--	--	18.00
Upstate Banks					
State Bank of Albany	18.00	18.00	15	None	18.00
Bankers Trust Company of Albany, N.A.	18.00	18.00	15	25¢ per item	12.00
Oneida National Bank & Trust Company (Utica)	18.00	18.00	None	None	18.00
Key Bank of Central New York (Syracuse)	19.00/12.00***	12.00	None	None	12.00
Lincoln First Bank, N. A. (Rochester)	18.00	18.00	12	None	16.00
Central Trust Company of Rochester	18.00	18.00	None	None	18.00
Marine Midland Bank, N.A. (Buffalo)	18.00	18.00	7.50-15****	None	18.00
Manufacturers & Traders Trust Company (Buffalo)	18.00	18.00	15	None	18.00
Liberty National Bank & Trust Company (Buffalo)	18.00	18.00	None	None	18.00

*This Table includes changes in rates and fees announced by mid-February, bu[t] which will not be effective until later, generally sometime during March.
**Customers with both a MasterCard and a Visa account will be charged $12 for ea[ch]
***The rate is 18% on first $500 and 12% on excess.
****The annual fee is $7.50 for NOW account depositors and $15 for everyone els[e]

upstate cities. It should be noted that since several New York City banks as well as some of the large upstate banks have branches in various upstate communities, their rates and charges are available in many different parts of the State.

As a result, there is a range of choices available to the public among banks in each of the major upstate cities. For example, in the Albany area, the following rates are available from banks with offices there (Table 4):

- On home improvement loans, different banks are charging 16.25%, 17%, 18% and 19%.
- On new car loans, the rates are 16.50%, 17% and 18%; on used car loans, 16.75%, 17%, 18% and 19%.
- On loans secured by savings or time accounts, 12%, 16%, 17%, 18% and 18.25%.
- On overdraft checking loans, the rates are 12%, 17% and 18%; on other unsecured personal loans, 17%, 18%, 18.25% and 19%.
- On credit cards, the prevailing rate is 18% with a $15 annual fee. However, one bank has no annual fee and another levies a $7.50 fee for its NOW account customers; some banks have a 25¢ per item charge on cash advances while others have no such charge; and one bank's fee is $15 but will charge $12 per card for holders of both Visa and MasterCard.

Similar patterns of variation in rates, fees and charges are evident in the Utica, Syracuse, Rochester and Buffalo areas (Tables 5-8). Even these tabulations may understate the actual degree of variation available to the public since they do not include all of the banks with offices in these areas, some of which did not respond to the survey.

TABLE 4

ANNUAL PERCENTAGE RATES AND CHARGES
ON CONSUMER CREDIT
SELECTED COMMERCIAL BANKS
WITH OFFICES IN THE ALBANY AREA
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
State Bank of Albany	18.00%	18.00%	18.00%
Bankers Trust of Albany, N.A.	18.00	16.50	18.00
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00**
Chemical Bank	17.00	17.00	17.00
Bank of New York	19.00	17.00	19.00
Marine Midland Bank, N.A.	18.00	18.00	18.00

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
State Bank of Albany	18.00%	9.00%	18.00%	18.00%
Bankers Trust of Albany, N.A.	16.00	9.00	--	17.00
Chase Manhattan Bank, N. A.	18.25	9.00	--	18.25
Chemical Bank	12.00	9.00	9.00	19.00
Bank of New York	17.00	9.00	--	19.00
Marine Midland Bank, N.A.	17.00	9.00	18.00	18.00

	Credit Card				Overdraft Checking Loans
	Purchases	Cash Advances	Annual Fees	Other Charges	
State Bank of Albany	18.00%	18.00%	$15	None	18.00%
Bankers Trust of Albany, N.A.	18.00	18.00	15	25¢/adv.	12.00
Chase Manhattan Bank, N.A.	18.00	18.00	15	***25¢/adv.	17.00
Chemical Bank	18.00	18.00	15-12	25¢/adv.	18.00
Bank of New York	18.00	18.00	None	None	18.00
Marine Midland Bank, N.A.	18.00	18.00	7.50-15	****None	18.00

* This Table includes changes in rates and fees announced by mid-February but which will not be effective until later, generally in March.

** Depending on age of car.

*** Customers with both a MasterCard and a Visa account will be charged $12 fo each.

**** The fee is $7.50 for NOW account customers and $15 for everyone else.

TABLE 5

ANNUAL PERCENTAGE RATES AND CHARGES
ON CONSUMER CREDIT
SELECTED COMMERCIAL BANKS
WITH OFFICES IN THE UTICA AREA
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
Oneida National Bank & Trust Company	16.00%	15.78%	17.63%
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00**
Chemical Bank	17.00	17.00	17.00
Marine Midland Bank, N.A.	18.00	18.00	18.00
Key Bank of Central New York	16.00	16.00	16.00
Lincoln First Bank, N.A.	18.00	17.00	18.00

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
Oneida National Bank & Trust Company	13.00%	9.00%	--	18.00%
Chase Manhattan Bank, N.A.	18.25	9.00	--	18.25
Chemical Bank	12.00	9.00	9.00%	19.00
Marine Midland Bank, N.A.	17.00	9.00	18.00	18.00
Key Bank of Central New York	18.00	9.00	--	18.00
Lincoln First Bank, N.A.	17.00	9.00	--	18.50

	Credit Cards				
	Purchases	Cash Advances	Annual Fees	Other Charges	Overdraft Checking Loans
Oneida National Bank & Trust Company	18.00%	18.00%	None	None	18.00%
Chase Manhattan Bank, N.A.	18.00	18.00	$15	25¢/adv.	17.00
Chemical Bank	18.00	18.00	15-12***	25¢/adv.	18.00
Marine Midland Bank, N.A.	18.00	18.00	7.50-15****	None	18.00
Key Bank of Central New York	18.00-12.00*****	12.00	None	None	12.00
Lincoln First Bank, N.A.	18.00	18.00	12	None	16.00

* This Table includes changes in rates and fees announced by mid-February but which will not be effective until later, generally in March.

** Depending on age of car.

*** Customers with both a MasterCard and a Visa account will be charged $12 for each.

**** The fee is $7.50 for NOW account customers and $15 for everyone else.

***** 18% on the first $500; 12% on the excess.

TABLE 6

ANNUAL PERCENTAGE RATES AND CHARGES
ON CONSUMER CREDIT
SELECTED COMMERCIAL BANKS
WITH OFFICES IN SYRACUSE AREA
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
Key Bank of Central New York	16.00%	16.00%	16.00%
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00**
Chemical Bank	17.00	17.00	17.00
Bank of New York	19.00	17.00	19.00
Marine Midland Bank, N.A.	18.00	18.00	18.00
Lincoln First Bank, N.A.	18.00	17.00	18.00

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
Key Bank of Central New York	18.00%	9.00%	--	18.00%
Chase Manhattan Bank, N.A.	18.25	9.00	--	18.25
Chemical Bank	12.00	9.00	9.00%	19.00
Bank of New York	17.00	9.00	--	19.00
Marine Midland Bank, N.A.	17.00	9.00	18.00	18.00
Lincoln First Bank, N.A.	17.00	9.00	--	18.50

	Credit Cards: Purchases	Credit Cards: Cash Advances	Annual Fees	Other Charges	Overdraft Checking Loans
Key Bank of Central New York	18.00-12.00%***	12.00%	None	None	12.00%
Chase Manhattan Bank, N.A.	18.00	18.00	$15	25¢/adv.	17.00
Chemical Bank	18.00	18.00	15-12****	25¢/adv.	18.00
Bank of New York	18.00	18.00	None	None	18.00
Marine Midland Bank, N.A.	18.00	18.00	7.50-15*****	None	18.00
Lincoln First Bank, N.A.	18.00	18.00	12	None	16.00

* This Table includes changes in rates and fees announced by mid-Februar but which will not be effective until later, generally in March.

** Depending on age of car.

*** 18% on the first $500; 12% on the excess.

**** Customers with both a MasterCard and a Visa account will be charged $12 for each.

***** The fee is $7.50 for NOW account customers and $15 for everyone else.

TABLE 7

ANNUAL PERCENTAGE RATES AND CHARGES
ON CONSUMER CREDIT
SELECTED COMMERCIAL BANKS
WITH OFFICES IN ROCHESTER AREA
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
Lincoln First Bank, N.A.	18.00%	17.00%	18.00%
Central Trust Company	17.50	17.50	17.50
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00**
Chemical Bank	17.00	17.00	17.00
Marine Midland Bank, N.A.	18.00	18.00	18.00
Key Bank of Central New York	16.00	16.00	16.00

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
Lincoln First Bank, N.A.	17.00%	9.00%	--	18.50%
Central Trust Company	--	9.00	--	18.50
Chase Manhattan Bank, N.A.	18.25	9.00	--	18.25
Chemical Bank	12.00	9.00	9.00%	19.00
Marine Midland Bank, N.A.	17.00	9.00	18.00	18.00
Key Bank of Central New York	18.00	9.00	--	18.00

	Credit Cards				Overdraft Checking Loans
	Purchases	Cash Advances	Annual Fees	Other Charges	
Lincoln First Bank, N.A.	18.00%	18.00%	$12	None	16.00%
Central Trust Company	18.00	18.00	None	None	18.00
Chase Manhattan Bank, N.A.	18.00	18.00	15	25¢/adv.	17.00
Chemical Bank	18.00	18.00	15-12***	25¢/adv.	18.00
Marine Midland Bank, N.A.	18.00	18.00	7.50-15****	None	18.00
Key Bank of Central New York	18.00-12.00*****	12.00	None	None	12.00

* This Table includes changes in rates and fees announced by mid-February but which will not be effective until later, generally in March.

** Depending on age of car.

*** Customers with both a MasterCard and a Visa account will be charged $12 for each.

**** The fee is $7.50 for NOW account customers and $15 for everyone else.

***** 18% on the first $500; 12% on the excess.

TABLE 5

ANNUAL PERCENTAGE RATES AND CHARGES
ON CONSUMER CREDIT
SELECTED COMMERCIAL BANKS
WITH OFFICES IN THE BUFFALO AREA
February 1981*

	Home Improvement Loans	New Car Loans	Used Car Loans
Marine Midland Bank, N.A.	18.00%	15.00%	16.00%
Manufacturers & Traders Trust Company	19.12	19.56	15.61
Liberty National Bank & Trust Company	18.00	15.00	18.00
Chase Manhattan Bank, N.A.	16.25	17.00	16.75-18.00**
Chemical Bank	17.00	17.00	17.00
Bank of New York	18.00	17.00	19.00

	Loans Secured By Savings Or Time Accts.	NYHEAC Educ. Loans	Other Educ. Loans	Other Unsecured Personal Loans
Marine Midland Bank, N.A.	17.00%	9.00%	18.00%	18.00%
Manufacturers & Traders Trust Company	19.61	9.00	—	19.62
Liberty National Bank & Trust Company	18.00	9.00	18.00	18.00
Chase Manhattan Bank, N.A.	18.25	9.00	—	18.25
Chemical Bank	12.00	9.00	9.00	19.00
Bank of New York	17.00	9.00	—	19.00

	Credit Cards				Overdraft
	Purchases	Cash Advances	Annual Fees	Other Charges	Checking Loans
Marine Midland Bank, N.A.	18.00%	18.00%	$7.50-15***	None	18.00%
Manufacturers & Traders Trust Company	18.00	18.00	15	None	18.00
Liberty National Bank & Trust Company	18.00	18.00	None	None	18.00
Chase Manhattan Bank, N.A.	18.00	18.00	15****	25¢/adv.	17.00
Chemical Bank	18.00	18.00	15-12	25¢/adv.	18.00
Bank of New York	18.00	18.00	None	None	18.00

* This Table includes changes in rates and fees announced by mid-February but which will not be effective until later, generally in March

** Depending on age of car.

*** The fee is $7.50 for NOW account customers and $15 for everyone else.

**** Customers with both a MasterCard and a Visa account will be charged $12 for each.

Moreover, although commercial banks are, at the present time, the major suppliers of consumer credit in New York State, effective March 1, 1981 thrift institutions will be able to offer a much broader range of personal loans than before, including automobile loans and issuance of credit cards. This means additional competition and an even wider range of alternative sources of consumer credit for the public will become available.

Variation in rates currently is also evident among other types of lenders in the consumer credit field, including thrift institutions, licensed lenders, automobile dealers and retail stores.

The detailed findings of the survey are set forth in Section III.

III. DETAILED FINDINGS OF THE SURVEY

Commercial Banks

Responses were received from 135 commercial banks, of which 113 were headquartered outside New York City and 22 were headquartered in the City. Some banks did not report interest rates on all types of loans specified in the questionnaire because they did not offer such loans. This was particularly true for non-guaranteed education loans and the issuance of credit cards.

Generally, the survey indicated that interest rates at most banks for most types of consumer loans have increased from their November 28, 1980 levels, with the increases averaging about 4 percentage points. By January 2, 1981, the New York City bank rates usually averaged higher than those upstate, with the gap larger than on November 28. There was a wide range of rates evident both in New York City and upstate (Tables 9 to 12).

On new car loans, the average interest rate statewide was 12.5% on November 28, 1980, 15.3% on December 1 and 16.7% by January 2. The New York City rate was higher than the upstate rate on January 2, although it had been lower than the upstate rate on the two earlier dates.

On loans involving cars less than two years old, the average rates statewide on the three dates in the survey were 13.2%, 15.8% and 17.3%, respectively. The rates averaged about the same for older used cars. The average rate on January 2 was higher in New York City than upstate, with the gap wider on that date than on November 28.

11

[illegible] CASH [illegible]

[illegible]

		Elsewhere in State		
	[illegible]	[illegible] 26, [illegible]	Dec. 1, 1980	Jan. 2, 1981
		[illegible]	7.00%	8.68%
		[illegible]–7.00	7.00–7.50	7.00–9.00
		12.41	14.67	16.54
	19.[illegible]	7.00–[illegible]	7.00–20.00	9.00–20.00
[illegible] Loans				
	19.30	13.20	16.[illegible]	[illegible].32
	1[illegible]–21.[illegible]	10.00–14.5[illegible]	10.00–21.00	12.00–21.00

TABLE 10

ANNUAL PERCENTAGE RATES
CONVENTIONAL HOME IMPROVEMENT LOANS,
LOANS SECURED BY SAVINGS OR TIME ACCOUNTS
AND OVERDRAFT CHECKING LOANS
COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981
	Conventional Home Improvement Loans					
Average Rate	12.91%	14.90%	18.14%	12.62%	15.64%	17.10%
Range of Rates	12.00-13.38	12.00-19.00	12.70-21.00	10.00-14.39	10.00-20.00	12.00-20.00
	Loans Secured by Savings or Time Accounts					
Average Rate	12.66	13.52	16.64	11.72	13.41	14.40
Range of Rates	8.50-13.88	7.25-19.00	12.00-20.00	6.25-14.57	6.25-19.60	6.25-19.60
	Overdraft Checking Loans					
Average Rate	12.00	12.00	13.39	12.03	12.21	12.72
Range of Rates	12.00-12.00	12.00-12.00	12.00-18.00	12.00-12.90	12.90-18.00	12.00-20.00

TABLE 11

ANNUAL PERCENTAGE RATES
ON EDUCATION LOANS AND
OTHER UNSECURED LOANS
COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov.28, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan.2, 1981
	Loans Guaranteed by NYHEAC					
Average Rate	7.00%	7.00%	8.50%	7.00%	7.00%	8.68%
Range of Rates	7.00-7.00	7.00-7.00	7.00-9.00	7.00-7.00	7.00-7.00	7.00-9.00
	Other Education Loans					
Average Rate	9.96	9.96	13.00	12.41	14.67	16.54
Range of Rates	7.00-13.38	7.00-13.38	7.00-19.00	7.00-13.38	7.00-20.00	9.00-20.00
	Other Unsecured Personal Loans					
Average Rate	13.21	14.97	18.30	13.10	16.10	17.32
Range of Rates	9.50-14.42	9.50-19.00	13.38-21.00	10.00-14.57	10.00-21.08	12.00-21.08

TABLE 12

ANNUAL PERCENTAGE RATES
ON CREDIT CARDS
COMMERCIAL BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981
	For Purchases - Balances Up To $500					
Average Rate	18.00%	18.00%	18.18%	18.00%	18.00%	18.06%
Range of Rates	18.00-18.00	18.00-18.00	18.00-19.80	18.00-18.00	18.00-18.00	18.00-19.80
	For Purchases - Balances Over $500					
Average Rate	12.00	12.00	12.78	12.00	12.00	12.25
Range of Rates	12.00-12.00	12.00-12.00	12.00-19.80	12.00-12.00	12.00-12.00	12.00-19.80
	For Cash Advances					
Average Rate	12.00	12.00	13.38	12.00	12.00	12.99
Range of Rates	12.00-12.00	12.00-12.00	12.00-19.80	12.00-12.00	12.00-12.00	12.00-19.80

For conventional home improvement loans, the average interest rate statewide was 12.7% on November 28, 15.5% on December 1 and 17.2% on January 2. The New York City rates averaged higher than those outside New York City on January 2, with the gap wider on that date than it had been on November 28.

On loans secured by savings or time accounts, the statewide average on the three dates in the survey were 11.9%, 13.4% and 14.8%, respectively. The New York City rates averaged higher than those outside the City on all three dates, with the widest gap evident on January 2.

Overdraft checking loan rates averaged 12.0%, 12.2% and 12.8% statewide on the three dates covered in the survey. By January 2, New York City rates averaged higher than those upstate while they had averaged slightly lower in New York City on the two previous dates.

On educational loans guaranteed by the New York Higher Education Assistance Corporation, the rates were 7% at all banks both in and outside of New York City on November 28 and December 1. This was the maximum permitted by NYHEAC regulations. Those regulations authorized an increase in the rate to 9% on January 1, 1981. Most banks raised their rates to the 9% level on January 2, increasing the statewide average to 8.7%, with the upstate rate averaging higher than in New York City. For non-guaranteed educational loans, the average rates statewide were 12.1%, 14.1% and 16.1%, respectively, for the three dates, with upstate bank rates substantially higher than those in New York City.

The rates on other unsecured personal loans averaged 13.1%, 15.9% and 17.5%, respectively. The New York City rate averaged higher than the upstate rate on January 2, with the gap wider than on November 28.

On credit cards, all banks were charging 18% on the first $500 and 12% on the excess over $500 on both November 28 and December 1, 1980, while on cash advances, all banks were at 12%. These rates represented the legal maximum on November 28. By January 2, 1981, only one New York City bank and one upstate bank* had increased rates (to 19.8%) to new customers, although this higher rate was not applicable on that date to previous credit card holders because of the notice requirements of State law.

As previously indicated in Section II of this Report, many of the New York City and upstate banks have announced increases in their rates, most of which will not go into effect until March or even later. Taking these announced rates into effect, it is evident that the prevailing rate will be 18% on all credit card purchases and cash advances although two New York City banks and one upstate bank are charging 19%, 19.8% and 19.8%, respectively.

Annual fees on credit cards are $15 at many banks although fees of $12, $7.50 and zero are reported by some institutions. A few banks, mainly in New York City, also impose a 25 cent per item charge on cash advances.

*Both banks were subsidiaries of Citicorp: Citibank, N.A., in New York City and Citibank (New York State),N.A., in Buffalo.

Almost all banks indicated that they charged the same rates at all offices and more than 80% of the respondents stated that their rates were the same for all customers.

Telephone inquiries made in late February of 10 large New York City commercial banks and 9 large upstate banks indicated that four of the New York City banks and four of those upstate had increased the availability of credit, as compared with its availability before the rate ceilings were eliminated, by such means as re-entering the market for consumer loans, liberalizing credit standards or raising credit line limits. Four of the New York City banks reported an increase in the volume of consumer loans made as did two of the upstate banks; the others reported either a decline or no significant change in loans made. Five of the New York City banks have increased their advertising for consumer loans; upstate, only one bank had increased its advertising although two others indicated they anticipate doing so. Five of the New York City banks that had announced an annual fee on their credit cards reported losing customers while three of those without fees indicated that they were being flooded with new applications for credit cards. Outside New York City, only one of the five banks that imposed credit card fees has lost customers while two of the four banks which are not charging a fee reported increases in the number of credit card customers.

Savings Banks

Responses were received from 97 savings banks, of which 62 were headquartered outside New York City and 35 were headquartered in the City. Some of the banks did not report interest rates on all types of loans covered by the questionnaire either because they were not legally empowered to make such loans or, for various reasons, chose not to offer these loans at various times.

In general, rates on the various types of consumer loans made by savings banks increased from their November 28 levels. Rates at banks outside New York City averaged higher than those in the City on January 2, with the gap wider on that date than on November 28. In addition, there were wide dispersions among banks in the rates charged on most types of loans (Tables 13 and 14).

On conventional home improvement loans, the average interest rate statewide was 12.3% on November 28, 13.5% on December 1 and 15.1% on January 2. By January 2, most banks had increased their rates from the November 28 level. The rates outside New York City averaged somewhat higher than in the City on January 2, with the gap wider on that date than on November 28.

On overdraft checking loans, the statewide average was 11.9% on both November 28 and December 1, increasing to 12.4% by January 2. The rates outside New York City averaged somewhat higher than those in the City on January 2, with the gap wider than on November 28.

TABLE 13

ANNUAL PERCENTAGE RATES
ON HOME IMPROVEMENT LOANS,
OVERDRAFT CHECKING LOANS AND
LOANS SECURED BY SAVINGS OR TIME ACCOUNTS
SAVINGS BANKS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov.28, 1980	Dec.1, 1980	Jan.2, 1981	Nov.28, 1980	Dec.1, 1980	Jan.2, 1981
Home Improvement Loans						
Average Rate	12.10%	12.10%	14.78%	12.33%	13.92%	15.17%
Range of Rates	12.00 - 13.00	12.00 - 13.00	12.00 - 19.00	10.85 - 13.00	10.85 - 18.00	10.85 - 18.00
Overdraft Checking Loans						
Average Rate	11.79	11.79	12.16	12.02	12.02	12.51
Range of Rates	8.50 - 12.00	8.50 - 12.00	8.50 - 12.00	12.00 - 12.17	12.00 - 12.17	12.00 - 18.00
Loans Secured by Savings or Time Accounts						
Average Rate	9.24	9.18	9.56	10.03	10.11	10.80
Range of Rates	7.50 - 13.00	7.50 - 13.00	7.50 - 16.00	6.50 - 13.00	6.50 - 16.00	6.50 - 16.00

With respect to loans secured by savings or time accounts, the statewide average on the three dates in the survey were 9.7%, 9.8% and 10.3%, respectively. The upstate rates were higher than those in New York City on January 2, with the gap wider than on November 28.

On educational loans guaranteed by the New York Higher Education Assistance Corporation, the rates averaged 7% both in and outside of New York City on November 28 and December 1. Most banks had raised their rates to 9% by January 2, increasing the average to 8.6%. Only a few banks made non-guaranteed educational loans. The average rates on these were 11.6%, 12.3% and 13.8%, respectively, for the three dates in the survey, with upstate bank rates substantially higher than those in New York City.

All the respondents indicated that they charged the same rates at all offices and the preponderance of banks stated that their rates were the same for all customers.

The telephone survey made during February of a sample of New York City and upstate savings banks indicated that two of the six banks had increased their rates on some types of loans since January 2 and that there was some variation in rates on loans secured by savings or time accounts (Table 15).

TABLE 15

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
SELECTED SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS
IN NEW YORK STATE

FEBRUARY, 1981

	Conv'l Home Improv't Loans	Over-draft Check'g Loans	Loans Secured by Savings or Time Acc'ts	NYHEAC Educ'n Loans	Other Educ'n Loans
New York City Banks					
Dime Savings Bank of N.Y.	--	12.00%	10.75%	9.00%	--
Dry Dock Savings Bank	--	--	10.00	9.00	7.00%
Seamen's Savings Bank	--	12.00	9.00	9.00	--
Upstate Banks					
Erie Savings Bank	--	--	10.50	9.00	--
Rochester Savings Bank	11.90%	12.00	12.00	9.00	18.00
Syracuse Savings Bank	--	18.00	12.00	9.00	--
New York City Associations					
Edison SLA	--	--	10.75	--	--
Sunnyside SLA	--	--	12.00	9.00	--
Washington Federal SLA	--	18.00	8.50	9.00	--
Upstate Associations					
Eastman SLA	17.00	12.16	8.50	9.00	17.00
Homestead SLA	14.00	--	8.50	9.00	--
Schenectady SLA	--	--	14.00	9.00	--

Savings and Loan Associations

Responses were received from 73 savings and loan associations, of which 51 were outside New York City and 22 were in the City. Virtually none of the respondents offered overdraft checking loans or non-guaranteed education loans.

Generally, rates on those types of consumer loans made by savings and loan associations have increased from their November 28 levels. The upstate rates usually averaged higher than those in New York City with the widest gap evident on January 2. For most types of loans, there was some variation in rates charged by different institutions (Table 16).

None of the New York City associations made conventional home improvement loans on November 28 or December 1 and only two reported a rate, which averaged 16.0%, on January 2. Outside New York City, the rates averaged 12.5%, 13.8% and 15.7%, respectively.

The average rate charged on educational loans guaranteed by the New York Higher Education Assistance Corporation was 7% on November 28 and December 1, both in New York City and upstate. The statewide average rose to 8.6% on January 2, with the upstate average higher than in New York City.

On loans secured by savings or time accounts, the statewide average was 9.5%, 9.7% and 10.3% on the three dates in the survey. The New York City rate was slightly higher than the upstate rate on November 28 while on the other two dates, the upstate rates were higher.

TABLE [illegible]

ANNUAL PERCENTAGE RATES
ON HOME IMPROVEMENT LOANS, EDUCATION LOANS
AND LOANS SECURED BY SAVINGS OR TIME ACCOUNTS
SAVINGS AND LOAN ASSOCIATIONS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	[illegible] 1980	[illegible] 1981	[illegible] 1982	[illegible] 1980	[illegible] 1981	[illegible] 1982
Home Improvement Loans						
Average Rate	--	--	[illegible]	[illegible]	[illegible]	[illegible]
Range of Rates	--	--	[illegible]	[illegible]	[illegible]	[illegible]
Loans Guaranteed by [illegible]						
Average Rate	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Range of Rates	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Loans Secured by Savings or Time Accounts						
Average Rate	9.56	9.47	9.74	9.42	[illegible]	[illegible]
Range of Rates	7.50 - [illegible]	7.50 - [illegible]	7.50 - [illegible]	6.50 - [illegible]	6.50 - 16.00	6.50 - [illegible]

All respondents indicated that their rates were uniform at all offices and all but one indicated that their rates were the same for all customers.

Based on the February telephone survey of a sample of institutions, there were no rate increases reported since January 2, except for guaranteed education loans at two of the associations. There was some variation in rates indicated on loans secured by savings or time deposits.

Licensed Lenders

A total of 23 licensed lenders responded to the questionnaire survey, most of which were outside the New York City metropolitan area. Not all lenders made all the types of loans indicated on the questionnaire forms.

In general, the survey indicated that the preponderance of the respondents had raised their rates to 25% by December 1 (Table 17) although the two largest licensed lenders in the State, accounting for more than 60% of all the loans outstanding of that industry, were charging rates of 23% to 24.4%.

On automobile loans, the average interest rate statewide was slightly over 20% on November 28, 1980. By December 1, all but one of the nine lenders who reported they made such loans had raised their rates to 25% and remained at that level on January 2.

The rates on other secured loans averaged almost 19.6% statewide on November 28 and over 24.1% on December 1. By the latter date, 13 of the 18 respondents were charging 25%; by January 2, 16 of the 18 respondents were at 25%.

On unsecured personal loans, the average rate statewide was 19.5% on November 28 and 23.4% on December 1. By January 2, it averaged slightly over 24%, with 15 of the 22 respondents charging 25%.

Each of the respondents indicated that its rates were uniform at all offices for all customers.

The telephone survey in February of four of the largest

TABLE 17

ANNUAL PERCENTAGE RATES
ON CONSUMER LOANS
LICENSED LENDERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981
Car Loans						
Average Rate	--	--	--	20.07%	24.44%	24.89%
Range of Rates	--	--	--	18.18-24.28	19.99-25.00	24.00-25.00
Other Secured Loans						
Average Rate	19.35%	22.96%	24.50%	19.66	24.46	24.93
Range of Rates	18.18 - 21.00	18.85 - 25.00	23.00 - 25.00	18.00 - 24.28	19.99 - 25.00	24.00 - 25.00
Unsecured Personal Loans						
Average Rate	19.35	22.96	24.50	19.59	23.47	23.91
Range of Rates	18.18 - 21.00	18.85 - 25.00	23.00 - 25.00	18.00 - 24.28	18.20 - 25.00	18.20 - 25.00

NOTE: Three of the four lenders with offices in New York City also have offices outside New York City. Those lenders tabulated as being outside New York City have no offices in the City.

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licensed lenders in the State indicated that they were charging rates ranging from 23% to 25% (Table 18). In addition, the four licensees indicated that while previously they had been somewhat reluctant to extend credit because of the high cost of borrowed money relative to the rates they could charge to borrowers, they were now making more credit available. One lender indicated that it had liberalized its credit standards which had previously been restrictive. Two of the four licensees reported that their volume of loans had risen substantially; the other two indicated no appreciable change.

TABLE 18

ANNUAL PERCENTAGE RATES ON CONSUMER LOANS
SELECTED MAJOR LICENSED LENDERS
IN NEW YORK STATE
February 1981

	Car Loans	Other Secured Loans	Unsecured Personal Loans
Beneficial Finance Co.	--	23.00%	23.00%
Household Finance Corp.	--	23.47-24.40*	23.47-24.40*
Avco Financial Services of N.Y.	--	25.00	25.00
Domestic Finance Corp.	--	25.00	25.00

* The higher rate is the A.P.R. for $3,000 loans; the lower rate for a $4,000 loan.

Automobile Dealers

Responses were obtained from 83 automobile dealers, the bulk of whom were outside New York City. Not all the dealers reported information on all the types of automobile financing covered in the questionnaire.

Overall, the survey revealed that rates on automobile loans have increased since November 28 with no consistent pattern of differences between the average New York City dealer rates and those upstate. There were substantial variations in rates among dealers in New York City as well as upstate (Table 19).

On new car loans, the average interest rate statewide was almost 12.7% on November 28, 1980. A majority of the respondents reported increases in their rates on December 1, so that the average on that date stood at 15.4%. By January 2, all but two of the respondents had increased their charges from the November 28 level, with the average rising to over 17.1%. There was virtually no difference in the average rate of dealers in New York City as compared with those elsewhere in the State on January 2.

On loans involving cars less than two years old, the average rate statewide was 17.1% on November 28, 19.4% on December 1, and 20.4% on January 2. On January 2, there was no difference between the average rate of New York City dealers and those upstate.

On cars more than two years old, the rates averaged 20.2%, 21.1% and 21.8% respectively, for the three dates covered in the survey, with the rates upstate averaging slightly higher than those

TABLE 19

ANNUAL PERCENTAGE RATES
AUTOMOBILE DEALERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov. 29, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981
			New Car Loans			
Average Rate	12.68%	16.45%	17.11%	12.66%	15.31%	17.14%
Range of Rates	12.69 - 12.68	12.68 - 23.75	12.68 - 23.75	12.25 - 12.94	12.50 - 19.03	12.68 - 19.34
			Loans on Cars Less Than 2 Years Old			
Average Rate	17.06	19.74	20.41	17.05	19.32	20.41
Range of Rates	14.52 - 17.44	17.68 - 22.65	17.68 - 22.65	13.13 - 18.82	14.32 - 23.07	17.02 - 23.75
			Loans on Cars More Than 2 Years Old			
Average Rate	19.81	21.04	21.71	20.27	21.11	21.82
Range of Rates	17.68 - 22.65	17.68 - 23.61	17.68 - 23.61	14.32 - 23.07	14.32 - 23.91	17.63 - 24.25

in New York City.

With rare exceptions, the respondents indicated that their charges were uniform at all their places of business for all their customers.

The telephone survey of a selected group of dealers in February indicated that none had changed their rates since January 2 and that there continued to be some variation in rates (Table 20).

Information obtained by letter from the trade association for automobile dealers in New York State indicated that, based on a meeting of the association's board of directors on January 21, 1981, dealers were reporting no automobile financing problems anywhere in the State for the average consumer. Of the six dealers contacted by telephone by the Banking Department, none indicated any change in credit policy due to the elimination of rate ceilings or any increase in the volume of automobile financing. However, two dealers indicated that the sales finance company to whom their contracts were sold seemed "more willing" to make such purchases although there was no formal change in policy, while another dealer stated that marginal consumers might now receive loan approval where previously they had not.

[illegible]

TABLE [illegible]

[illegible]

	[illegible]	[illegible]	
		[illegible]	[illegible]
[illegible]			
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]			
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]

Furniture Dealers and Other Retailers

Responses were received from only one of the 31 selected New York City furniture dealers to which questionnaires were sent and from 16 other retailers throughout the State.

1. Furniture Dealers - In view of the almost total lack of response from the furniture dealers, the Banking Department sent out examiners in February, posing as shoppers, to 22 of the New York City furniture dealers to determine the current rates they charged. Nine of these dealers indicated that they did not extend credit to their customers. Data were therefore obtained for the remaining 13 based upon oral quotations provided by store personnel, plus the one dealer who responded to the questionnaire and whose current rates were obtained by phone.

Based on the information obtained, the finance charges range from 13.5% to 28.7%, with the rates for 10 of the 14 stores below 24%. In some instances, the rate includes insurance and data could not be obtained to exclude such insurance.

At most of the furniture stores, the examiners were also quoted a cash sales price which was substantially below the price which credit customers must pay. The present provisions of the federal Truth-in-Lending laws would require that the difference between the cash price and the price which credit customers must pay for an item be included as part of the finance charge and reflected in the APR for purposes of Truth-in-Lending disclosures.

On this basis, the rates ranged from 21.3% to 208.2%, in some cases including insurance, with the rates for seven of the nine stores involved between 21.3% and 35.3%.

It should be noted, however, that there is pending before Congress a bill which would eliminate the present provisions of law that require certain cash discounts to be included in the finance charge for Truth-in-Lending purposes. The Banking Department has been advised that favorable action on this bill is likely.

2. Other Retailers - Of the other retailers in the survey, 16 responded to the questionnaire, nine of which were located outside New York City.

None of the respondents had changed their rates between November 28, 1980 and January 2, 1981. All but one were charging 18% on revolving credit balances of $500 or less and all were charging 12% on balances over $500 throughout this period (Table 2). These charges were uniform at all their places of business in New York State.

Most of the respondent retailers did not offer closed-end credit. Of those that did, in most cases they indicated their rates were the same as for their revolving credit accounts.

In addition, all but one respondent said either that there were no monthly charges levied on 30-day accounts (where the total outstanding balance is due and payable by the next payment date) or that they did not offer such accounts.

TABLE 21

ANNUAL PERCENTAGE RATES
ON CONSUMER CREDIT
AT RETAILERS IN NEW YORK STATE

	In New York City			Elsewhere in State		
	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981	Nov. 28, 1980	Dec. 1, 1980	Jan. 2, 1981
	Indebtedness of $500 or Less					
Average Rate	18.00%	18.00%	18.00%	18.00%	18.00%	18.00%
Range of Rates	18.00 - 18.00	18.00 - 18.00	18.00 - 18.00	17.97 - 18.00	17.97 - 18.00	17.97 - 18.00
	Indebtedness of Over $500					
Average Rate	12.00	12.00	12.00	12.00	12.00	12.00
Range of Rates	12.00 - 12.00	12.00 - 12.00	12.00 - 12.00	12.00 - 12.00	12.00 - 12.00	12.00 - 12.00

The February telephone survey of selected retailers indicated that all were charging 18% on the first $500 of revolving credit balances and 12% over $500, with no other fees or charges. One large retailer (Macy's) indicated that effective March 10, 1981 or on subsequent dates in March and April depending upon the billing cycle, its rates on revolving credit balances would be increased to 19.8% (Table 22).

Recent newspaper accounts indicated that several other large retailers are increasing their charges on revolving credit accounts. Montgomery Ward has announced an increase to 21.6% effective April 1, 1981 on its revolving credit accounts, while Sears, Roebuck is increasing its rate to 21%, effective on various dates in March depending upon the billing cycle.

TABLE 22

ANNUAL PERCENTAGE RATES
ON CONSUMER CREDIT
SELECTED RETAILERS
IN NEW YORK STATE
February 1981

	Instalment Credit or Store Charge Cards		Annual Fees Or Other Charges
	Credit of $500 or less	Credit over $500	
New York City Retailers			
Macy's New York, Inc.	18%*	12%*	None
J. C. Penney Co., Inc.	18	12	None
Associated Dry Goods Corp.	18	12	None
Upstate Retailers			
Bruce Hall Corp. (Cooperstown)	18	12	None
Harry T. Mangurian Inc/ (Rochester)	18**	12**	None
Wilsons Jewelers (Syracuse)	18	12	None

* Effective March 10, 1981 and on subsequent dates in March & April, depending upon the billing cycle, these rates will be increased to 19.8%

** Effective May 1, 1981, these rates will be increased to 21½%.

NOTE: All of these retailers either did not offer 30-day accounts or levied no charges for such accounts.

IV. CONSUMER EDUCATION PROGRAM

In light of the findings of this survey indicating that banks are offering a wide range of rates and fees, thereby providing consumers with alternative choices, it is particularly significant that the Banking Department, at the direction of the Superintendent, embarked on a broad campaign immediately after passage of the Omnibus Banking Bill to educate the public about the new law and urge that consumers shop for credit.

As part of this campaign, the Department developed a brochure entitled "Shopping for Credit - A Consumer Guide for Credit in New York State". The brochure is structured in question-and-answer form which addresses many of the questions consumers have about the new law and urges them to shop for the best credit deal available. More than 3 1/2 million brochures have already been distributed to financial institutions which made them available throughout their branching systems, consumer groups, legislative leaders, large private employers and New York State employees.

In addition, all TV, radio and news publications located in New York State were sent a copy of the brochure with a personal request from the Superintendent that they inform their audiences of the brochure's availability. A number of these media responded to this request, including WABC-TV and WOR-TV which will run public service announcements with the message that consumers should shop for credit.

In conjunction with the distribution of the brochure, the

Department received generous assistance from the Outdoor Advertising Association of New York State. This industry association, through its membership, arranged for free billboard space throughout the State which urges the public to shop for credit and indicates the availability of the Department's brochure.

The outdoor advertising campaign has also been extended to include the savings banks and commercial banks industries. The outdoor advertising campaign for savings banks began at the end of February and will continue through the end of March, with the commercial banks participating from the end of March until the end of April. Approximately 250 posters for each industry will be erected around the State with the distribution being coordinated by the Outdoor Advertising Association. These posters will perpetuate the Department's theme of the need to shop for the best credit deal available.

During the course of this effort, the Superintendent held press conferences at the unveiling of billboard signs located in Manhattan on December 18, 1980, in Buffalo on January 13, 1981 and in Syracuse on January 21, and made appearances on major television and radio networks in Albany, Buffalo and Syracuse. On February 18, the Superintendent joined with New York City Council President Carol Bellamy for a press conference and unveiling of a billboard sign located in Brooklyn.

The Department has also received from the New York City Transit Authority a public service donation of advertising space on subway cars for 6,000 advertising posters whose content is the same as the billboard posters. This will include two advertising posters for every other subway car and will appear on all three branches of the New York City subway transit system. The subway campaign will last three months and represents a media value of approximately $45,000.

Senator LUGAR. Apparently from your testimony, both written and now oral testimony, there was evidence that interest rates did not skyrocket after the New York experience, and that deregulation simply led to a proper allocation to the market, as opposed to allocation by federal preemption?

Mr. LAFALCE. Absolutely.

Senator LUGAR. Thank you very much.

Senator TOWER. Senator Dodd?

Senator DODD. Just very briefly, Mr. Chairman, I'd like to welcome my former colleague from the House. We were elected in 1974 together.

It's a pleasure, John, to have you before the committee. I'm going to be following with great interest—as the others in this committee are—your proposal.

Just one point. I guess you said at some point in your testimony something about 50 percent rates. Obviously, that seems unrealistic at this point.

But just as a theoretical matter, of course, were the Congress to adopt the LaFalce/Lugar, Lugar/LaFalce legislation, there is—there would be, of course, no restriction and in fact, theoretically the rate could go that high, without any kind of control at all?

Mr. LAFALCE. Well, when I used 50 percent, I was making an analogy. I said that a 10-percent limit in Arkansas, when the interest rate was 2 or 5 percent, would mean, if we were to pass a comparable interest rate ceiling today, when the prime is 20—if it was going to be comparable to what it was 50 or 100 years ago, when Arkansas' was passed, it would have to be 50.

Senator DODD. You say you'd oppose that, obviously, if it got that high? You wouldn't want to see it get that high?

Mr. LAFALCE. I really think that, you know, if we passed a 50-percent limit, it would have absolutely no effect whatsoever—I'm not advocating that—because you would still get your interest at, you know 20-plus right now. It would depend upon what the prime was.

If, however, we set it, say, at 23 percent, then even if it dropped down to about 18 or 17 percent, I think that we might see virtually everybody, you know, up at 23, rather than coming down to 22 or 21. In other words, if we ever did engage in a Federal ceiling, it would have to be sufficiently above whatever we would anticipate possible future interest rates at, so that it would not act as the level where everybody would set their interest rates at, rather than just a prohibition against unconscionable rates.

Senator DODD. I wasn't suggesting you were advocating a 50-percent ceiling. What I guess I was getting at is, without any kind of ceiling or linking it to anything—CPI, or the Fed discount rate whatever it may be—that you run theoretically the potential of it going that high, depending on what happens with interest rates and market forces.

Mr. LAFALCE. What we would be depending upon would be competition in the marketplace to set the limits.

Senator DODD. Potentially, if you didn't have good healthy competition within the market, you run the risk anyway of having unscrupulous lenders charge 40 percent, 50 percent. That's theoretically possible, of course.

Mr. LaFalce. It's theoretically possible, but I think that, other than for the principle of noncontradiction, virtually everything else imaginable is theoretically possible.

Senator Dodd. Thank you.

Senator Lugar [presiding]. Thank you very much.

Any more questions?

Senator Dixon. No.

Senator Lugar. Thank you very much, Congressman LaFalce for coming. We appreciate your testimony.

Mr. LaFalce. Thank you.

Senator Lugar. The Chair would like to call now Dr. Robert W. Johnson, director of the Credit Research Center, Purdue University, West Lafayette, Ind.

Dr. Johnson, welcome to the committee. We appreciate your coming. Will you please proceed with your testimony.

STATEMENT OF DR. ROBERT W. JOHNSON, DIRECTOR, CREDIT RESEARCH CENTER, PURDUE UNIVERSITY

Dr. Johnson. I will summarize my prepared statement as briefly as possible.

I appreciate the invitation of this committee to appear and to testify.

As Senator Lugar has indicated, my name is Robert W. Johnson. I am director of the Credit Research Center, a nonprofit research organization that is part of Purdue University.

Speaking in terms of my own personal opinion and not representing the views of Purdue University, I would compliment both S. 1406 and S. 963 on two dimensions.

First of all, both bills are moving in the right direction in attempting to remove restrictions on rates that consumers pay for the use of credit. Having set a course to remove restrictions on rates that savers can earn, Congress is now moving to relieve creditors who use those savings directly or indirectly of the limits on the rates that they can charge.

If you will spare me a down-home-in-Indiana analogy, it seems to me at present we're in a situation analogous to the Federal Government's having removed price controls on chicken feed, while allowing each State to set rigid price ceilings on chickens or the parts thereof.

Both bills recognize the economic irrationality of that position.

Second, both bills preserve the States' rights to enact and to retain and to adjust consumer protection provisions. And I think it is entirely appropriate to leave the States to this complex task. However, there are some differences in the approaches of S. 1406 and S. 963 to which I would like to address myself.

RATES TIED TO THE DISCOUNT RATE

First of all, S. 1406 provides complete relief from rate ceilings, analogous to the relief provided on savings, whereas S. 963 ties the ceilings to the Federal Reserve discount rate. I see some fairly major problems with that latter approach.

First of all, I don't think that the rate ceiling is going to be high enough. If we go back to back to February 1981, the Federal Reserve discount rate was 13 percent. Even if allow the surchar

of 3 percent, plus the additional 1 percent, that would provide us with an optional Federal ceiling of only 17 percent.

At that time, Federal Reserve reports show that the average typical rate charged by banks on 12-month personal loans was 17.3 percent; on credit card plans, around 18 percent; and finance company used car loans, at 19.4 percent. Thus, S. 963 would simply not let the free market operate, since the proposed rate ceilings would already be below the free market rate.

Second, as indicated earlier, the Federal Reserve discount rate is a poor index. It is a rate administered for monetary policy. It is a short-term rate, but many lenders borrow in the long-market. For example, the finance companies get about 46 percent of their borrowed funds in the long-term market.

Finally, the Federal Reserve discount rate in no way reflects the operating costs of creditors, which are very substantial in many cases in the consumer credit field. For example, in 1979 the average of operating costs of medium-sized bank card divisions was 61 percent of total income. And those operating costs are completely unrelated to the short-term Federal Reserve discount rate.

DRAMATIC INCREASE IN REVOLVING CREDIT

Finally, S. 963 does not provide for preemption of fees or charges paid for availability of credit, as provided in S. 1406. This difference is directly relevant to revolving credit, a very popular and important kind of credit in this country. Total revolving credit from year-end 1972 to year-end 1980 grew at a rate of about 30 percent, compounded annually. Bank card credit grew at a compound annual rate of just under 20 percent. This is a very popular kind of credit.

But you heard in your oversight hearings that revolving credit these days generally is either unprofitable or only marginally profitable. A good share of the problem stems from the fact that many credit card users avoid paying any finance charges. Thirty to forty percent pay in full every month.

VISA has reported that about half of its monthly collections pay off card balances in full, without paying any finance charge. S. 963 would permit State laws to continue in effect that prohibit levying an annual fee or a transaction fee, or charging from the date of purchase. Yet, these cardholders are receiving major important free services. They are getting credit from the date of purchase to the date of payment, which may range up to 50, 55 days, of credit. They are getting a credit line which they can draw at will. They are getting the convenience of transactions at the point of sale.

We have studies at the Credit Research Center that show what nonrevolvers are like—that is, those people that pay in full every month—versus people who do not revolve and who pay a finance charge every month, or most months.

We drew on the sample that was under the auspices of a survey conducted by the Survey Research Center at the University of Michigan. It was sponsored in mid-1977 by the Federal Reserve Board, the FDIC, and the Comptroller of Currency. They sampled over 2,500 consumers on a nationwide basis.

We split the sample into two parts: Those consumers who held credit cards who said they almost always paid in full every month

versus the rest of the consumers who said they sometimes paid in full and other consumers who said they seldom paid in full.

The differences were very striking, and I suspect you could all anticipate what those differences would be.

The family income of the people receiving the free services, the nonrevolvers, was $2,305 on a monthly basis versus $1,765 for the revolvers, a difference of $540 a month. The nonrevolvers were older, had smaller families.

Respondents were asked: "Do you find it difficult to save in advance for major purchases?" Forty-six percent of the nonrevolvers said "No;" 17 percent of the revolvers said "No."

We also discovered that the nonrevolvers used their credit services much more than the revolvers. They took advantage of the transaction service. They had many more transactions per month than did the revolvers. They were frequent users of credit.

In summary, the people who are avoiding paying the finance charge under many State laws are affluent, upstream consumers, who make active use of their credit cards.

S. 963 continues the protection provided these consumers by many States against their paying for the credit services they use. S. 1406 removes that shield.

Another major difference is that S. 963 is scheduled to end in April 1, 1983, while S. 1406 continues until Congress decides otherwise. It seems to me if it makes sense to decontrol the price charged for credit to reflect the decontrol of the cost of funds to creditor in 1981, it makes even greater sense in 1983 to continue that decontrol. The basic economic principles do not change in 21 months.

Further, under the Deregulation Act, we should have even more competition in 1983 than we have now, given the broader powers that you have given to the savings and loan associations, credit unions, savings banks, and other creditors.

We have no sunset provision on the deregulation of savings rates. It seems counterproductive to have such a provision on the price of credit.

Finally, I have one small quibble on S. 1406 with respect to section 533(c). I am not an attorney, but as I read that section, it would permit States to take certain types of credit or certain types of creditors and reimpose rate ceilings on those particular types of credit or creditors. It seems to me that it leads to that kind of credit allocation which this committee would prefer to avoid.

For example, it leads to a situation where creditors might gang up on another kind of creditor. They might gang up on State-chartered credit unions or finance companies in an effort to stifle their competitive power by reimposing rate ceilings on particular types of creditors. And that is anticompetitve. We have a history of that in this country.

Take as one example Iowa—I am not picking on Iowa, we can find other similar cases. Prior to the passage of the Uniform Consumer Credit Code in July 1, 1974—that's the effective date—finance companies were limited to rates of 26 to 36 percent, but could not make loans in excess of $1,000. On the other hand, we had commercial banks which were limited to an annual percentage rate of 12 percent, but they could make loans up to $5,000. In the

1960's, that was not a bad dollar amount. But this clearly segmented the market. Finance companies were in one segment of the market. The legislature put the banks in another segment of the market, and that led to less competition.

We have other studies at the Credit Research Center that shows the anticompetitive effect of segmented rate ceilings.

I would prefer to see that section deleted so that creditors who would want to reimpose rate ceilings on their competitors would realize that they would also be under the rate ceilings, and we would stifle that initiative to go back and compete in the legislature, rather than to compete in the marketplace.

In summary, if Congress will pass S. 1406, perhaps with the deletion of subsection 533(c), in substantially the form in which it is before this committee, I think we can make one of the most significant steps in this generation toward a free and efficient market for business, agricultural, and consumer credit.

Thank you.

[Complete statement follows:]

STATEMENT OF

ROBERT W. JOHNSON

DIRECTOR, CREDIT RESEARCH CENTER

KRANNERT GRADUATE SCHOOL OF MANAGEMENT

PURDUE UNIVERSITY, WEST LAFAYETTE, INDIANA

Mr. Chairman and Members of the Committee:

My name is Robert W. Johnson, Director of the Credit Research Center, Purdue University. The Credit Research Center (CRC) is a nonprofit research organization that was established in 1974 as a part of Purdue University. Over the first five years of our existence, about half of our financial support has come from various government agencies and about half from unrestricted grants from a broad cross-section of the credit industry. More recently, we have come to rely more heavily on unrestricted grants from a diverse industry group. As a matter of policy, all of our research findings are made available to the public.

I am appearing at your invitation to present my views on S. 1406 and S. 963. These are my personal views and I am not speaking on behalf of the Credit Research Center or Purdue University.

SIMILAR BASIC OBJECTIVES

The basic objective of these two bills is similar and laudable. Having set on a course to remove restrictions on the rates that savers can earn, Congress is now moving to relieve creditors--who directly or indirectly use those savings--of limits on the rates that they can charge. As this Committee has heard in recent oversight hearings, restrictive rate ceilings mean that creditors either cannot pay the market rate for savings or will have to restrict the availability of credit to consumers. Consequently, leaving creditors in a squeeze between rising cost of funds and fixed restrictions on the prices that they can charge for those funds will adversely affect consumers, industry and the national economy. We are in a situation that is analagous to the

government's having removed price controls on chicken feed, while retaining rigid price ceilings on chickens. Each of these bills recognize the economic irrationality of that position.

While these bills address the national interest in releasing rate ceilings on consumer, business, and agricultural credit, they preserve the consumer protection provisions enacted by State legislatures. This common objective is also laudable. As this Committee heard many times in the oversight hearings, rate ceilings do not protect consumers. They merely reduce the availability of cash credit to many consumers, forcing them instead to obtain credit indirectly through retail outlets or from illegal lenders. In contrast, legislation governing delinquency charges, collection remedies, balloon payments, refunds upon prepayment and the like do protect consumers. State legislators have designed packages of consumer protection that they believe appropriate for their citizens, and it is befitting that Congress allow this responsibility to remain with the States.

In this connection, it is worth pointing out that the Bureau of Consumer Protection of the Federal Trade Commission does not share this view. As you know, they have proposed an extensive series of restrictions on creditors' collection remedies that would, by Federal regulatory action, effectively preempt State laws in this area.[1] As we shall see, this proposed Trade Regulation Rule is relevant to the relative merits of the two bills before us.

The bills permit State legislators to reject the federal preemption of State rate ceilings on consumer credit within 21 months to three years. In all fairness, I must say that this provision seems inconsistent with the absence of a similar provision that would permit States to over-ride

the phasing out of interest rate ceilings on deposit accounts. Quite properly, Congress has not granted an interval for the States to impose lower rate ceilings on the deposits of State-chartered institutions than are permitted by the Deregulation Act. Any State foolish enough to impose such a limit would obviously force deposits out of State-chartered institutions into Federally-chartered institutions and money market funds. By the same token, as this Committee has previously learned, any State that over-rides the preemption of State rate ceilings on consumer, agricultural and business credit would distort the flow of funds both within the State and nationally. Returning to my earlier analogy, if we do not permit the States to reject the phasing out of price controls on chicken feed, why should they be permitted to negate the release of price ceilings on chickens? I doubt that the provision raises a serious problem, since State legislators generally seem to be aware of the increasing need to deregulate the prices paid for credit by business and consumers, just as we have deregulated the cost of those funds.

DIFFERENCES IN APPROACH

While the two bills, S. 1406 and S. 963 have the same basic objective, there are important differences in the manner in which this objective is to be achieved. Let me turn to an evaluation of those differences.

Rate Ceiling v. No Rate Ceiling

While S. 1406 provides for complete relief from State rate ceilings on agricultural, business, and consumer credit, S. 963 ties the Federal rate ceiling to the Federal Reserve discount rate. There appears to be a number of problems with this latter approach.

First, the proposed "flexible, optional" ceiling is not high enough to accommodate many forms of consumer credit, especially short-term credit for small amounts. In February of this year the ceiling rate would have been 14 percent (the Federal Reserve discount rate plus one percent.) Possibly, this ceiling would have been adjusted upwards by a three percent surcharge, although that was applicable only to short-term adjustment credit borrowing by large institutions in certain circumstances.[2] Thus, the ceiling would have been 14 percent or 17 percent, depending upon one's interpretation of the statute. Yet, in February 1981, the average rate charged by commercial banks on mobile homes was 16.58 percent; 17.34 percent on 12-month consumer loans; and 15.94 percent on new automobiles. Most bank credit card plans were at 18 percent on the initial portion of the unpaid balance. On average, finance companies were charging 19.37 percent to finance used cars; 21.42 percent on personal loans; and 29.96 percent on other consumer goods credit.[3] Since many of these rates were above or close to the optional Federal rates that would have been established under S. 963, it is apparent that the bill would have provided only slight additional rate flexibility. The citizens of only a few States, most notably Arkansas, would have benefited significantly from rate relief. Because the rate ceilings under S. 963 would in many cases have been below those already imposed by a diverse mixture of State rate ceilings, consumer credit would have remained constrained in many States. This Committee has received ample testimony concerning the unfavorable effects on the Nation's economy of allowing existing State rate ceilings to continue to distort the credit markets of the Nation.

Second, the Federal Reserve discount rate is probably inappropriate for indexing rate ceilings on consumer, business, and agricultural credit. It is a rate that is administered for monetary policy and does not necessarily reflect current market rates. Moreover, to the extent that it reflects market rates, it is basically a short-term rate. Yet, the cost of funds to creditors arises from a composite of short- and long-term funds. For example, at mid-1980, 46 percent of finance company debt was long-term.[4] Even more important, while the cost of funds has become increasingly important in the overall costs of providing consumer credit, operating costs still comprise a large portion of total costs. As illustration, among a sample of medium-sized banks in 1979, operating costs amounted to 23 percent of the total income of the instalment loan divisions and 61 percent of the total income of the credit card divisions.[5] Changes in operating costs over time are affected by inflation, but are almost entirely unrelated to the sharp movements in short-term money rates.

Finally, S. 963 does not allow for preemption of "fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees," as provided in S. 1406 [Part D, Sec. 532(a)(1)(B)]. This difference between the two bills will have a profound effect upon users and providers of revolving credit.

Consumers have embraced revolving credit as a convenient means of using credit. It provides an easy way to make a credit purchase at point of sale, a line of credit that may be drawn upon at will, and, generally, credit from the date of purchase to the date of payment. Over the past eight years (years-end 1972-1980), revolving credit

outstandings have grown at a compound annual rate of 25.5 percent, with commercial banks' holdings rising by 19.6 percent annually.

In spite of this phenomenal growth, you have heard in testimony in the oversight hearings that banks and others have found revolving credit to be unprofitable or, at best, marginally profitable. To a considerable extent, the poor profit picture of credit cards is attributable to the rate structure, in particular to the so-called "free period," whereby cardholders who pay their unpaid balance in full each month avoid paying a finance charge. In this case, they receive--at no direct cost--as much as 50 to 60 days of credit from the date of purchase to the date payment is made. These cardholders are termed "non-revolvers." Banks report that about 30 to 40 percent of their active accounts pay in full each month and that the proportion paying in full has been rising over the past several years. In May 1980, Visa, U.S.A reported that 37 percent of its active cardholders, who accounted for half of Visa's volume, incurred no finance charges. Those consumers who do not pay in full and thereby incur a finance charge are termed "revolvers."

This Committee faces two basic choices. On the one hand, under S. 963 it can continue State laws that, in effect, mandate a free credit period on revolving credit by prohibiting annual or monthly fees, transaction fees, or similar charges. Such State laws protect non-revolvers. On the other hand, under S. 1406 it can preempt those State laws and permit firms offering revolving credit to change their pricing structures to assess non-revolvers for their use of credit services. From our studies at the Credit Research Center, we can show this Committee how

non-revolvers differ from revolvers so that you can determine whether you wish to preserve the shield now protecting the non-revolvers.

The data used in our study were collected in a national survey of 2,563 consumers in mid-1977.[6] The fieldwork was jointly sponsored by the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation. We concentrated our analysis on those consumers who used bank credit cards and who had reported their income, about 31 percent of the original sample.[7] We divided this subsample into revolvers and non-revolvers on the basis of their response to the question, "When you use bank cards or store cards, do you almost always pay the total amount due each month to avoid a finance charge, do you sometimes do this, or do you hardly ever pay in full and have to pay a finance charge?" About half of the respondents said that they almost always paid in full and were classified as non-revolvers.

The differences between the non-revolvers and revolvers were often striking, but much as you might expect (Exhibit 1). Non-revolvers had an average monthly family income of $2,305 compared to an average of $1,765 for the revolvers. Compared to revolvers, non-revolvers were older and had smaller families. Only three percent of non-revolvers were Black, compared to the nine percent of revolvers. Consumers were asked "What about saving money in advance for large purchases like furniture, refrigerators, and things like that--do you find it difficult, somewhat difficult or not at all difficult to save for them in advance?" Forty-six percent of the non-revolvers reported that they had no difficulty, compared to only 17 percent of the revolvers. Non-revolvers

EXHIBIT I

AVERAGE INCOME AND DEMOGRAPHIC CHARACTERISTICS OF REVOLVERS AND NON-REVOLVERS USING BANK CREDIT CARDS

Variable	Group Means Non-Revolvers	Revolvers	t-statistic[a]
	n = 389	n = 395	
Monthly Income	$2305	$1765	5.60*
Difficulty in saving for major purchases (1=No)	.46	.17	9.13*
Age greater than 55	.30	.15	5.12*
Number in household	2.78	3.34	5.24*
Race (1=Black)	.03	.09	3.48*b
High School Education or more	.72	.69	.94
Do not consider size of monthly payment an important loan contract term	.39	.24	4.59*
Use bank card frequently	.39	.24	4.59*

*Significant at .01 level of confidence

[a]The t-statistics were calculated on the assumption that for relatively large numbers of observations a binomial distribution can be approximated by a normal distribution.

[b]The t-statistic for the race variable is significant at the 1 percent level of confidence. However, with the small proportions for race, the test of difference may not be reliable.

Source: Credit Research Center, Working Paper No. 34, p. 11.

were less concerned about the size of the monthly payment than were revolvers.

In this study we found that non-revolvers used their cards frequently--39 percent compared to only 24 percent of revolvers. In an earlier study of 655 California bank cardholders we found that the more often consumers used their credit cards, the lower the finance rates that they paid (Exhibit 2).[8] Whereas, 56 percent of the low users paid an annual rate exceeding 14 percent, 54 percent of the high users paid two percent or less. Other data from the same study showed that frequent users were more likely to be consumers with incomes exceeding $25,000.

EXHIBIT 2

RELATIONSHIP OF ACCOUNT USE TO FINANCE RATE PAID

Those Whose Average Debits/ Mo. Were	Paid Annual Percentage Rates Of			
	2% or Less	2-14%	Over 14%	Totals
1 or less	28%	16%	$\boxed{56}$%	100%
1.01 - 2	25	26	49	100
2.01 - 7	36	28	36	100
Over 7	$\boxed{54}$	31	15	100
Totals	33%	25%	42%	100%

Source: Credit Research Center, California Band Card Study.

In summary, in comparison to revolvers, non-revolving credit cardholders who benefit from State prohibitions on annual fees and transaction charges are likely to be older, with higher incomes, and smaller families. They use their cards more frequently than revolvers and have less concern with meeting monthly payments and more ability to save in advance for major purchases. Put simply, they are better off than the revolvers. S. 963 continues the protection provided by some States against their paying for credit services; S. 1406 removes that shield.

Sunset Provision

S. 963 is scheduled to end on April 1, 1983, whereas S. 1406 will continue until Congress decides otherwise. As indicated earlier, the basic rationale for both bills is to relax or to release from State control the price charged for credit in order to reflect the fact that under The Deregulation Act Congress is phasing out controls on the cost of funds to creditors. To return to the analogy, having unfrozen the price of chicken feed, Congress is now very sensibly releasing price controls on chickens.

Let us agree that it makes sense to let the market set the price of credit services sold, now that we have decided to let the market set the cost of funds used. That decision will be just as rational and statesmanlike in April 1983, as it is in July 1981. Basic economic principles do not change in 21 months. Moreover, under The Deregulation Act the broader powers given to savings and loan associations, savings banks, and credit unions to provide consumer credit should make competition even more effective in 1983 than it is now in limiting the price of credit to consumers. If we have faith in truth-in-lending, we should

believe that free consumer credit markets will be workably competitive today and even more efficient in 21 months. Congress has already decided against a sunset provision in the deregulation of interest rates paid on consumers' time and demand deposits. I see no need for a sunset provision in the preemption of States' interest rate limitations on business, agricultural, and consumer credit.

State Over-ride Provision

I am not an attorney. But as I read S. 963, it appears that to over-ride the Federal preemption of State rate ceilings on business, agricultural, and consumer credit, the State legislature would have to reject all of "Part D - General Usury Over-ride." In contrast, as I read Section 533(c) of S. 1406, it appears that a State could over-ride the deregulation of rates for certain types of credit. If my analysis is correct, the provision of S. 1406 places the free market concept of rate deregulation in great jeopardy.

If one examines legislative history in the various States, grantors of consumer credit are not above trying to fence out potential competitors by persuading State legislatures to enact statutes limiting the maximum size and maturity of loans and the rates that can be charged. As illustration, in Iowa prior to the passage of the Uniform Consumer Credit Code effective July 1, 1974, finance companies could make loans at annual rates ranging from 26 percent to about 36 percent--but only up to $1,000. In turn, commercial banks were limited to an annual rate of 12 percent, but could make what were then large loans up to $5,000. It was a neat market segmentation by legislative decree. And, it was not a free market.

If I am reading subsection (c) of S. 1406 correctly, it appears to permit a return to those old market segmentation days. What is there to prevent other credit grantors from "ganging up" on State-chartered credit unions or finance companies and fencing them out of the free market by persuading the State legislature to establish restrictive rate ceilings on those "extensions of consumer credit" or "those types or kinds of covered charges?" In fact, the subsection appears to offer State legislators the opportunity to re-impose prohibitions of annual fees or transaction charges on revolving credit. If one credit grantor wishes to impose price ceilings on his competitors, he should understand that he will have to live with precisely that same restrictive price ceiling. That understanding should prove very helpful in gaining his support for free credit markets. If my interpretation of subection (c) is correct, I would urge that the Committee consider its deletion.

Finally, a further reason for requiring that relief from rate ceilings apply across the board to all forms of business, agricultural, and consumer credit is provided by the FTC's proposed trade regulation rule governing creditors' collection remedies. If this rule becomes, in effect, the law of the land, all creditors' costs will be increased. Thus, States should not be permitted to impose restrictive rate ceilings on some types of credit or creditors, while leaving others free of such limitations.

In summary, both S. 963 and S. 1406 reflect the need to deregulate the price of credit now that we are moving to let the market set the cost of credit; that is, the returns paid to savers. For the reasons stated, my preference would be S. 1406, with the deletion of subsection (c). If Congress will pass S. 1406 in that form, we can make the most significant move in our generation towards an unrestricted, free market for business, agricultural, and consumer credit.

FOOTNOTES

[1]See Credit Practices (Staff Report and Recommendation on Proposed Trade Regulation Rule 16 CFR Part 444; Public Record 215-42). Washington, D.C.: Bureau of Consumer Protection, Federal Trade Commission, August 1980.

[2]Effective December 5, 1980, a three percent surcharge was applied to short-term adjustment credit borrowings by institutions with deposits of $500 million or more who borrowed in successive weeks or in more than four weeks in a calendar quarter.

[3]Federal Reserve Statistical Releases E.12 (122); E. 4 (144); and E.10 (120)

[4]Evelyn M. Hurley, "Survey of Finance Companies, 1980," Federal Reserve Bulletin, 67 (May 1981), p. 401.

[5]Federal Reserve System, Functional Cost Analysis - 1979 Average Banks, pp. 27, 38. "Medium-sized banks" had deposits ranging from $50-$200 million.

[6]Thomas A. Durkin and Gregory E. Elliehausen, 1977 Consumer Credit Survey. Washington, D.C.: Federal Reserve Board, 1978.

[7]A. Charlene Sullivan and Robert W. Johnson, "Value Pricing of Bank Card Services," Working Paper No. 34. West Lafayette, IN: Credit Research Center, Purdue University, 1980.

[8]Robert W. Johnson, "Pricing of Bank Card Services," Journal of Retail Banking, 1 (June 1979), pp. 16-22.

Senator LUGAR. Thank you very much, Dr. Johnson.

You have touched upon my first question in your overall statement. But for the record, would you reiterate your answer to this question: You have claimed that rate ceilings do not truly protect consumers, although that is purportedly one of the main reasons for such ceilings. Could you explain the traditional rationale for rate ceilings and why that rationale is no longer valid in current circumstances?

Dr. JOHNSON. The basic traditional rationale—and also, I think, economic rationale—was formed, let's say, in the 1800's, when there was very little competition for the consumer's business. Consumers were regarded as poor risks, and only the most affluent consumers could obtain credit.

Given a noncompetitive market, it made sense to impose rate ceilings upon consumers who were in a poor bargaining position relative to credit grantors. We have a completely different situation today, as Congressman LaFalce has pointed out. We have vigorous competition.

To take as one example, California has never, to my knowledge, imposed rate ceilings on bank credit cards. But even before the days of truth in lending, bank rate charges in California were no higher than the rest of the country.

Similarly, a study made when I was on the National Commission on Consumer Finance showed that the rates charged by banks on new car loans were essentially at the same level in States without any rate ceiling at all, as they were in the rest of the country.

So the differences between what existed in our economy at the time usury laws were passed and what exists now is that we have much more vigorous competition, fostered in part by a bill this Congress passed, which was the truth-in-lending bill.

Senator LUGAR. Dr. Johnson, both you and the Federal Reserve Board believe the discount rate is inappropriate for indexing rate ceilings because it, as administered by the Federal Reserve Board, does not necessarily reflect the current market rate.

But your statement goes further and seems to imply that even a market rate index would not be very effective, because operating costs still comprise a large portion of the total costs.

Could you please explain further that portion of your testimony?

FIXED CEILING RATES

Dr. JOHNSON. Yes; there are a lot of fixed costs in extending credit which are unrelated to the amount of credit extended. If I make you a $100 loan, I have the acquisition costs, getting you on the books; I have monthly collection costs, which are fixed, regardless of whether I am getting $5 a month from you or $500 a month from you. Those costs, therefore, bulk very high as a percentage of the loan on small extensions of credit and much lower on large extensions of credit, as in the case of mortgage credit.

Consequently, a rate ceiling that is fixed to a money market rate, such as the Federal Reserve discount rate or the constant maturity 3-year Treasury bill rate, fails to take into account that there are consumers, less affluent consumers, who need small amounts of credit. In those cases, the costs of administering those loans for those consumers are very high as a percentage of the loan, much

higher than for large loans, and are largely unrelated to any kind of the money market index.

Consequently, if we are to preserve the availability of credit to consumers who need small amounts of credit, such as a revolving credit, we would do well to avoid tying the rate ceiling to some sort of money market plan.

Senator LUGAR. Dr. Johnson, during the uncertain economic times in which we are now involved, are rate ceilings more harmful to the economy than during more stable periods?

Dr. JOHNSON. I guess that depends on how high the rate ceiling is. The rate ceiling at almost any time is harmful to somebody. Somebody is being cut out of the cash credit market.

Even if you had a 25-percent rate ceiling, there are people who need credit, $200, $300, $400, even in these days, for at least two visits for the grocery store. And for those people, a rate ceiling of 25 percent is probably not high enough.

Senator LUGAR. Senator Dixon?

Senator DIXON. Dr. Johnson, I'm certainly, of course, openminded about this legislation, but I'd like to pursue philosophically with you for a moment the position you've taken here.

I come from your neighboring State of Illinois. When I went to the Illinois House in January of 1951, 30 years ago, our usury rate for an ordinary loan was 8 percent. The rate was correspondingly higher for what we called in those days a small loan and for revolving credit and things of that character.

All through the time I served in the 1950's in the house, that was no problem. By the time I had advanced to the Senate in 1962, there were beginning to be some rustlings about the rates, and in the middle 1960's some attention was addressed to those rates and some small increases in the rates were adopted in the Senate. By the late 1960's, it was becoming a rather acute problem because we were seeing some 9- and 9½-percent rates.

In 1970, I advanced to executive office in the State, but throughout the 1970's that whole question was highly volatile in Illinois, and the rates were being continuously increased, pegged at various types of outside rates to determine a rate that floated.

Just last month in June—our session ends on June 30—the president of the Illinois State Senate of my party was criticized pretty substantially for successfully passing legislation taking off the rates altogether. Some in my party of a more liberal persuasion than the president thought that was a dramatic thing to do. The point is, they have done that in Illinois.

I come to my question, which is, with all deference to my colleague from Indiana—and I have a special regard for the problem in Arkansas in view of the fact that it's a constitutional one—but this matter has been debated at great length, sometimes with considerable heat in a great many legislative bodies in a great many States of this Union.

You have pointed out that California for many years or perhaps never had a usury rate. Illinois now has none. Our colleague from the House from New York says that they no longer have one.

So I guess my question is, why do we preempt a question that so many States have addressed continuously for so many years?

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DEREGULATE RATES FOR CREDITORS

Dr. JOHNSON. I think the question strikes at the heart of this problem. My answer basically would be, you have deregulated savings rates on a national basis or are in the process of doing that. That is the basic source of funds for creditors. If you allow that rate to float on a national basis, it seems appropriate to allow the rates the creditors can charge to seek the market level on a national basis, rather than have the rate set by a patchwork quilt of rates in various States.

I am basically a States-righter myself and have felt somewhat uncomfortable. I was a strong supporter and very much involved in the Uniform Consumer Credit Code, which cannot be regarded as one of the most acceptable pieces of legislation that has been presented to the various States. Even though it had not been moved very fast, it was something that was before its time, I suspect. But given that record, I guess that I am at the point where, having released the rate ceilings on savings on a national basis, it now seems appropriate to release rate ceilings on the prices that the people who use those savings can charge for credit.

Now one correction: California has a usury statute. They do not happen to have a rate ceiling on bank credit cards. They have a rate ceiling on retail credit cards but not bank credit cards, and it is that kind of patchwork quilt that I think S. 1406 addresses.

Senator DIXON. I don't want to pursue the point unnecessarily, because the point is really moot for my State. But I would say that even in this bill we recognize some States' rights on the question when we suggest that we will preempt the field, but we will permit the States to respond within a 3-year period.

Do you find that a satisfactory response?

Dr. JOHNSON. If I were sitting where you are, I would feel that to be satisfactory. From a strictly economic standpoint, as I indicated in the prepared testimony, I am a little uncomfortable with it. But I do not think States at this point will come back and override the Federal preemption. I would hope they wouldn't.

Senator DIXON. I would just finally wonder, if we're going to exempt at all, why we say we'll exempt, but we still want to yield to you your rights in the field if you think otherwise within the 3-year period of time.

Dr. JOHNSON. I suggest there's some inconsistency in that position.

Senator DIXON. Given the correctness of your thesis—and I do support the thesis; I want you to know that.

Dr. JOHNSON. Thank you.

Senator LUGAR. Thank you, Senator Dixon.

Senator Dodd?

Senator DODD. Thank you, Mr. Chairman.

I should have said at the opening, Mr. Chairman, that I am really of an open mind on this legislation as well. I have some questions for both sides of the issue, and it's really with that in mind that I pursue these questions, not because I'm committed myself to a position on either the Lugar bill or the Bumpers bill at all. I want to come out with an answer that is proper.

You were a member, Dr. Johnson, as I understand it, of the National Commission on Consumer Finance back in 1970, a Presidential appointee; is that correct?

Dr. JOHNSON. Correct. We went out of business in 1972.

Senator DODD. My concerns have to do with the market forces, competition, that would exist.

There was a policy issued in 1972 by the National Commission on Consumer Finance, and I should have chapter and verse here for you, but let me quote it to you and then ask you the question, if you'll bear with me.

It says at the conclusion of the rate ceilings chapter, I'm quoting, it says:

> On the basis of a summary of the historical approach to the establishment of rate ceilings and institutional knowledge about them the Commission must conclude that, on balance, rate ceilings are undesirable when markets are reasonably competitive.

The report goes on to say:

> Rate ceilings in many states restrict the supply of credit and eliminate creditworthy borrowers from consumer credit markets. * * * But the statistical evidence considered here indicates that competition cannot be relied upon at this point in time to establish rates at reasonably competitive levels in many states. Raising rate ceilings in some areas where markets are highly concentrated would merely allow suppliers to raise prices, accept somewhat higher risks, but remain secure within the legal or other barriers which assure them that their market power and monopoly profits will not be diluted. Clearly, then, rate ceilings cannot be eliminated until workably competitive markets exist.

That was 1972; this is 1980. What's happened in 8½ years that causes—by the way, I should ask you first of all, did you agree with that? You were on the Commission; you may have taken a dissenting view.

Dr. JOHNSON. If you will look at the back of that report, Senator Proxmire and I have an interchange in which I am arguing that for the most part we really do not need the rate ceilings. At one point, we were talking of a rate ceiling target of about 42 percent, and at the last minute, that came out of the report. So I guess I was more on the side of favoring a freeing up of the rate ceilings than some of the other members of the Commission.

But to answer your question much more directly, I think a lot has happened in essentially 10 years since those words were written.

First of all, Congress has made important steps in allowing other people to enter the field—savings and loan associations; credit union powers have been expanded; rate ceilings have been raised for credit unions, allowing them entry into this market; savings banks have been permitted entry into the market. We have had a vast expansion in revolving credit, particularly at commercial banks, which has supplanted in many cases the small loans made by finance companies.

So the market now generally across the nation is workably competitive, and I do not think that I could point to any State other than Arkansas where I think the market would not work efficiently. And I think it would work very quickly and adjust very quickly even in the State of Arkansas. We have no consumer finance companies, for example, in Arkansas. With the release of t e

ceilings, I would expect them to move in very quickly and provide vigorous competition to other creditors in the State.

Senator DODD. Let me just quote from the report of the Interagency Task Force on Thrift Institutions. They said that "usury ceilings could be set at levels that are not binding, for purposes of the operation of competitive markets, but that would reduce the occurrence of usurious lending practices."

RELIEF TO LENDERS AND CONSUMERS

In effect, if we adopt either bill, in a sense we're going to be providing some relief, obviously, to lenders. Why would it not also be wise at least to try and provide some parameter of protection for consumers? If we have seen a change in the last 8½ to 9 years from the position in 1972, certainly that can occur again. I suppose we can end up going back. Once we've set a process in motion, shouldn't we be trying at least to provide some outside limit protection against what could occur if competitive forces in the market, for whatever reason, dissipate, diminish, or are significantly reduced?

Dr. JOHNSON. That is somewhat the approach that England uses. They have an upper limit of 48 percent, and any contracts below 48 percent are deemed prima facie evidence of a conscionable contract. Anything over 48 percent is prima facie evidence of a unconscionable contract, although rates as high as 80 percent have been approved in court.

The other approach is the Swedish approach. The Swedes are generally regarded as the most protectionist nation in the world, at least among industrial nations, yet they have no rate ceiling at all. And that approach would be consistent with S. 1406, which says to let the market set the rates.

And when you say, "I want an upper limit—50 percent or 48 percent," I guess my response is, well, why not an upper limit on prices for men's shirts or automobiles or tires. We have truth in lending; that was marketed as a law that would permit consumers to shop for credit. And if I recall Senator Douglas' introduction, it was to shop for credit just as consumers shop for gasoline and potatoes. And if we think we can shop effectively for potatoes, why can't we shop effectively for credit, given the law that this Congress has passed providing for truth-in-lending disclosure?

Senator DODD. My time has expired.

Senator LUGAR. Dr. Johnson, is not the problem one that is historical or in a sense a part of the ethos of banking, and that is that there is a long-time feeling, both literary as well as maybe actual, that interest is unearned income, that there ought to be some sort of limits on this type of income as opposed to incomes of other sorts?

But even if this is true, the point that you have made today is that, the Congress has eliminated the prohibition on how much those who are savers can attain. I suppose, to the one that you have mildly chastised in S. 1406, would be a State preemption with regard to the amount of money that could be paid to people who are earning money from money market funds or from S. & L.'s or what have you, that States could come in and say that for the

protection of whoever it is we are protecting, savers should receive only 5 percent or 6 percent?

In essence, the point that you are making is, if we have deregulated altogether the savings side but not the side that lenders can charge, we have a skewed system in such a way that we are almost bound to run into grief.

STAGEFRIGHT FEELING

I accept that point, and in fact I share your free market ethic. I would say the predicament the committee faces is that there is a small stagefright feeling on this committee, this Congress, and this country. The thought of proceeding in a purely free market way, as Senator Dixon in his testimony or his questioning has elicited from you, seems to me to run into the political realities that there are many who would feel that in the past this has been handled by States, and some very well—the State of Illinois most recently.

And you have, I think, gently said, "This is our predicament." But is this a fatal flaw in the bill? How strongly would you argue, just to play the devil's advocate, that this 533(c) clause flaws S. 1406 to the point that we really ought to remove it? Or would you have mercy and compassion upon the committee? How do you sort of balance these thoughts?

Dr. JOHNSON. I guess that's not my position in the first place. From a political standpoint, I suspect that it is necessary to permit States to return to the position that existed prior to the Federal preemption. And I would certainly not argue against that position, given the need to recognize States' rights.

My only point was to require the States to go all the way, go back to where they were entirety before the Federal preemption. Don't permit the States to cherrypick and say, "We'll put finance companies back under the old rules, but let's let the rest of the industry go ahead without any rate ceilings."

I recognize your position and would say, "Fine, I certainly would not argue against allowing States to override and return to the position that exists as of 1981." But I would not want to see the States be able to pick out certain types of credit—let's say to reimpose a prohibition of an annual fee on a bank credit card—just because people who are nonrevolvers are affluent and likely to write their legislators, I do not see why they should be protected from paying an annual fee to pay for the credit services that they're obtaining.

Senator LUGAR. Senator Dodd, do you have additional questions?

Senator DODD. Only—you were talking about potatoes and shirts and other items. I know probably more than anything else, I guess you would be using those as illustrative examples, not to make too direct a comparison between the availability of financing and the availability of potatoes in the sense of the economic implications that are associated with consumer default or the unavailability of a consumer to buy a shirt.

I'm wondering if you'd like to address for 1 minute anyway what the economic implications might be with significant consumer default, and has that been a part of your thinking in terms of the overall deregulation?

Dr. JOHNSON. Let me see if my answer is responsive, Senator Dodd.

CONSUMER PROTECTION

One of the current arguments we hear occasionally for restrictive rate ceilings is that they protect consumers from getting into debt and being hassled by creditors to repay, the agonies of phone calls and the embarrassment of not being able to repay. And, therefore, to protect those consumers who are by implication not bright enough to know how much debt they can carry, we eliminate them from the market by restrictive rate ceilings.

There are two answers to that. First of all, you don't eliminate them from the market; you only eliminate them from the cash credit market. Instead, they obtain credit from retailers and pawn shops and other such sources of credit. (I do not mean to put retailers in the same class as pawn shops.) We found, for example, in the study of Arkansas that Arkansas consumers had almost exactly the same amount of per capita debt as did consumers in Illinois. But the per capita amount of credit was very different by type of credit. They had much less cash loan credit and much more retail credit in Arkansas than in Illinois. So you do not protect consumers in the first place.

Second, it seems to me, there is a certain amount of arrogance to say that because in a given risk class, 7 percent of those consumers are going to have trouble repaying their debts, that we ought to deny credit to the other 93 out of 100 consumers because 7 out of 100 are going to have problems. So I do not go along with this argument that to protect consumers from their own misjudgments, we ought to have rate ceilings to cut them out of the legal, cash credit market.

I'm not sure that's responsive to your question, sir.

Senator DODD. Thank you.

Senator LUGAR. Thank you, Senator Dodd. Thank you very much, Dr. Johnson.

Senator LUGAR. The Chair would like to call now a panel of witnesses:

Mr. W. P. Conners, executive vice president of Ford Motor Credit Co., Detroit, Mich.; Mr. Gordon E. Gilbert, senior vice president, Coachmen Industries, Inc., Middlebury, Ind., on behalf of the Recreation Vehicle Industry Association; Mr. Wendell H. Miller, president of Miller Motor Corp., Binghamton, N.Y., on behalf of the National Automobile Dealers Association; and Mr. Hugh B. Chalmers, president of the Arkansas Automobile Dealers Association, from West Memphis, Ark.

STATEMENTS OF W. P. CONNERS, EXECUTIVE VICE PRESIDENT, FORD MOTOR CREDIT CO.; GORDON E. GILBERT, SENIOR VICE PRESIDENT, COACHMEN INDUSTRIES, INC., ON BEHALF OF THE RECREATION VEHICLE INDUSTRY ASSOCIATION; WENDELL H. MILLER, PRESIDENT, MILLER MOTOR CORP., ON BEHALF OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION; AND HUGH B. CHALMERS, PRESIDENT, ARKANSAS AUTOMOBILE DEALERS ASSOCIATION

Senator LUGAR. Gentlemen, welcome to this hearing. I will ask you to give opening comments in the order that you have been

introduced. That would mean Mr. Conners first, Mr. Gilbert, Mr. Miller, and Mr. Chalmers.

If possible, if you could summarize your testimony in about 5 minutes, that would be helpful. We don't want to compress things unduly, but all of your statements will be made a part of the record in full. And those committee members who are here—and several who are not—have read the statements and have some idea of the gist of what you have to say.

Please, if you will, highlight the important points. We will lead off with Mr. Conners.

Mr. CONNERS. Thank you very much, Mr. Chairman.

My name is William P. Conners. I am executive vice president of Ford Motor Credit Co. I have responsibility for North American automotive financing operations. I welcome the opportunity to testify before this committee, and to express the views of Ford Credit on the subject of financing rates.

Ford Credit, a subsidiary of Ford Motor Co., is a nationwide finance company, with 148 automotive finance branch offices serving the entire United States. Ford Credit provides a full range of financing accommodations to Ford Motor Co. dealers and their customers.

As of May 31, 1981, Ford Credit held approximately 1.9 million consumer retail contracts, with outstanding balances aggregating more than $9 billion. Ford Credit also has about $3.5 billion in wholesale inventory financing for over 5,500 dealers, in addition to $190 million of capital loans to dealers.

We welcome Congress consideration of problems caused by restrictive rate ceilings. The volatility of the last several years in finance rates, the uncertainty and distress of general economic conditions, and the unpredictable outlook for the future make this examination timely and necessary. The issues before this committee are broader than automotive financing, because our problems are similar to those experienced throughout the entire finance industry.

The bills before this committee would, in various ways, take action with respect to State ceilings on financing. These proposals address the same basic problem that Congress focused on last year, in enacting title V of the Depository Institutions and Monetary Control Act of 1980. At that time, State ceilings on residential first mortgage credit were preempted. In addition, ceilings on agricultural and business credit were liberalized to the extent of applying a Federal ceiling of 5 percentage points above the Federal Reserve discount rate, including any surcharge.

One purpose of last year's legislation was, of course, to make funds available for consumers to purchase homes—an objective spurred by a distressed housing market. The thrust of the proposals under consideration today is the freeing up of credit for users with all needs, in addition to housing, by removal of ceilings for all credit.

CONSUMER FINANCING UNPROFITABLE

Ford Credit strongly endorses the need for such legislation because credit availability is important to consumers, to the health of the auto industry, and to the economy in general. Present ıd forecasted money costs make consumer financing in low-ra c

ing States unprofitable. Because of the cost penalties involved, some finance institutions have virtually withdrawn from automotive financing in these markets. Only the finance subsidiaries of the automotive manufacturers, such as Ford Credit, continue to operate broadly in markets like Arkansas—which has a rate ceiling of 10 percent—and only out of the desire and necessity to support our dealers and vehicle sales in that State.

Certainly we understand the concerns that led to enactment of rate ceilings. The unfortunate penalty of low-rate ceilings in times of high and volatile interest rates, however, is that consumers are denied access to credit because finance institutions cannot lend money at rates lower than their own costs.

Although the finance subsidiaries of auto manufacturers have continued to make automotive credit available under these difficult circumstances, their ability to replace other credit sources is limited

First, many potential customers do not apply for credit when they perceive that it is not available. Others will not buy a car or truck when their bank or credit union will not make the loan, or will do so only on restrictive terms.

Second, there is a financial burden on the auto manufacturers when their finance subsidiaries make credit available below cost. This adds to the already serious financial problems the manufacturers are experiencing because of the twin pressures of depressed sales and the enormous capital expenditures the industry faces.

For these reasons, Ford Credit endorses S. 1406, the Credit Deregulation and Availability Act of 1981, sponsored by four members of this subcommittee. This legislation would extend Federal preemption of State rate ceilings to all consumer financing; it would continue the business and agricultural credit regulatory relief; and it would eliminate the present $1,000 threshold.

STATES COULD OVERRIDE FEDERAL PREEMPTION

States would, however, retain the authority to override the Federal preemption, provided they take action within 3 years. This process is both a clean slate and a safety net. Individual State legislatures will have an opportunity to take a careful look at the hardships that have been caused by low-rate ceilings; they will be in a position to determine anew whether there are benefits that justify the adverse effects that restrictive rate ceilings have had upon consumers, business, and the economy.

Importantly, S. 1406 would not displace existing State licensing, supervision, and consumer protection provisions. These areas remain within the sole jurisdiction of State control.

In other words, S. 1406 clears the way for market forces to operate competitively with respect to credit charges and availability. These are very uncertain times, and while any rate ceiling or formula may make sense today, it may not be appropriate tomorrow. In our volatile economy, where short-term interest rates can rise as much as 5 percentage points in 2 months, as they did, for example, from March to May of this year, even frequent legislative adjustments are not able to keep pace with these rapidly changing circumstances. A number of States with low-rate ceilings have taken action to mitigate the serious impacts the ceilings were

having; nevertheless, many of these actions were in some way temporary or tied to formulas that may not be realistic in the future.

The facts are that when rate ceilings encumber the marketplace, everyone suffers. When the availability of credit for consumers and for business and agricultural purposes is curtailed, the adverse impact spreads throughout the job force and the economy. In such times, rate ceilings become price controls that are out of harmony with economic conditions, and as a result, become counterproductive. It is our strong belief that normal healthy competitive forces at work in the financing industry are the best means of attaining competitive rate structures that are responsive to fluctuations in the economy and to the need for credit availability at reasonable prices.

In summary, in a time of high money costs, when consumer credit is particularly impacted by often inadequate yields, Ford Credit is convinced that Federal relief from State ceilings is necessary, and in the best interest of consumers and business alike.

We support S. 1406 as providing an appropriate mechanism which preserves the States traditional regulatory rights in all other ways. We think it would be difficult to find a formula for a rate ceiling that would work under volatile conditions, which are likely in uncertain economic times, and therefore recommend that the process be left to the marketplace. We urge prompt congressional approval of this legislation, in order to eliminate the continued adverse impacts on consumers, on business, and on the economy in general.

[The complete statement of Mr. Conners follows:]

STATEMENT BY WILLIAM P. CONNERS, EXECUTIVE VICE PRESIDENT, FORD MOTOR CREDIT CO.

Mr. Chairman, my name is William P. Conners, Executive Vice President of Ford Motor Credit Company. I have responsibility for North American Automotive Financing Operations. I welcome the opportunity to testify before this Committee and to express the views of Ford Credit on the subject of financing rates.

Ford Credit, a subsidiary of Ford Motor Company, is a nationwide finance company with 148 automotive finance branch offices serving the entire United States. Ford Credit provides a full range of financing accomodations to Ford Motor Company dealers and their customers. As of May 31, 1981, Ford Credit held approximately 1.9 million consumer retail contracts with outstanding balances aggregating more than $9 billion. Ford Credit also has about $3.5 billion in whosesale inventory financing over 5,500 dealers, in addition to $190 million of capital loans to dealers.

We welcome Congress' consideration of problems caused by restrictive rate ceilings. The volatility of the last several years in finance rates, the uncertainty and distress of general economic conditions, and the unpredictable outlook for the future make this examination timely and necessary. The issues before this Committee are broader than automotive financing because our problems are similar to those experienced throughout the finance industry.

The bills before this Committee would, in various ways, take action with respect to state ceilings on financing. These proposals address the same basic problem that Congress focused on last year in enacting Title V of the Depository Institutions and Monetary Control Act of 1980. At that time, state ceilings on residential first mortgage credit were preempted. In addition, ceilings on agricultural and business credit were liberalized to the extent of applying a federal ceiling of five percentage points above the Federal Reserve discount rate, including any surcharge.

One purpose of last year's legislation was, of course, to make funds available for consumers to purchase homes—an objective spurred by a distressed housing market. The thrust of the proposals under consideration today is the freeing up of credit for users with all needs, in addition to housing, by removal of ceilings for all credit.

Ford Credit strongly endorses the need for such legislation because credit availability is important to consumers, to the health of the auto industry, and to the

economy in general. Present and forecasted money costs make consumer financing in low-rate-ceiling states unprofitable. Because of ther cost penalties involved, some finance institutions have virtually withdrawn from automotive financing in these markets. Only the subsidiaries of the automotive manufacturers, such as Ford Credit, continue to operate broadly in markets like Arkansas—which has a rate ceiling of 10 percent—and only out of the desire and necessity to support our dealers and vehicle sales.

Certainly we understand the concerns that led to enactment of rate ceilings. The unfortunate penalty of low rate ceilings in times of high and volatile interest rates, however, is that consumers are denied access to credit because finance institutions cannot lend money at rates lower than their own costs.

Although the finance subsidiaries of auto manufacturers have continued to make automotive credit available under these difficult circumstances, their ability to replace other credit sources is limited. First, many potential customers do not apply for credit when they perceive that it is not available. Others will not buy a car or truck when their bank or credit union will not make the loan, or will do so only on restrictive terms. Second, there is a financial burden on the auto manufacturers when their finance subsidiaries make credit available below cost. This adds to the already serious financial problems the manufacturers are experiencing because of the twin pressures of depressed sales and the enormous capital expenditures the industry faces.

For these reasons, Ford Credit endorses S. 1406, "The Credit Deregulation and Availability Act of 1981," sponsored by four members of this Subcommittee. This legislation would extend federal preemption of state rate ceilings to all consumer financing; it would continue the business and agricultural credit relief and it would eliminate the present $1,000 threshold. States would, however, retain the authority to override the federal preemption, provided they take action within three years. This process is both a clean slate and a safety net. Individual state legislatures will have an opportunity to take a careful look at the hardships that have been caused by low rate ceilings; they will be in a position to determine anew whether there are benefits that justify the adverse effects that restrictive rate ceilings have had upon consumers, business and the economy.

Importantly, S. 1406 would not displace existing state licensing, supervision, and consumer protection provisions. These areas remain within the sole jurisdiction of state control.

In other words, S. 1406 clears the way for market forces to operate competitively with respect to credit charges and availability. These are very uncertain times and while any rate ceiling or formula may make sense today, it may not be appropriate tomorrow. In our volatile economy where short-term interest rates can rise as much as five percentage points in two months as they did, for example, from March to May of this year, even frequent legislative adjustments are not able to keep pace with these rapidly changing circumstances. A number of states with low-rate ceilings have taken action to mitigate the serious impacts the ceilings were having; nevertheless, many of these actions were in some way temporary or tied to forumulas that may not be realistic in the future.

The facts are that when rate ceilings encumber the marketplace, everyone suffers. When the availability of credit for consumers and for business and agricultural purposes is curtailed, the adverse impact spreads throughout the job force and the economy. In such times, rate ceilings become price controls that are out of harmony with economic conditions and as a result become counterproductive. It is our strong belief that normal healthy competitive forces at work in the financing industry are the best means of attaining competitive rate structures that are responsive to fluctuations in the economy and to the need for credit availability at reasonable prices.

In summary, in a time of high money costs when consumer credit is particularly impacted by often inadequate yields—Ford Credit is convinced that federal relief from state rate ceilings is necessary and in the best interest of consumers and business alike. We support S. 1406 as providing an appropriate mechanism which preserves the states' traditional regulatory rights in all other ways. We think it would be difficult to find a formula for a rate ceiling that would work under volatile conditions which are likely in uncertain economic times and therefore recommend that the process be left to the marketplace. We urge prompt congressional approval of this legislation in order to eliminate the continued adverse impacts on consumers, business and the economy in general.

Senator LUGAR. Thank you very much, Mr. Conners.

I would like to call now upon Mr. Gilbert.

Mr. GILBERT. Thank you, Mr. Chairman.

My name is Mike Gilbert, and I'm senior vice president and a member of the executive committee of Coachmen Industries, Inc., Middlebury, Ind.

Coachmen manufactures recreational vehicles, boats, mobile homes, and accessories for these products. Our company is a very active member of our trade association, the Recreation Vehicle Industry Association, and I am on the RVIA's Finance Committee.

On behalf of my company and the Recreation Vehicle Industry Association, I want to thank you for the opportunity to comment on S. 1406 and S. 963.

As you suggested, in the interest of time, I'm going to limit my remarks and ask that my more complete statement, together with a policy position statement by the American Recreation Coalition—which includes 67 industries that are very much involved in this legislation—and I also represent them here today—I ask that that be submitted for the record.

Senator LUGAR. Without objection, so ordered.

Mr. GILBERT. I also have separate statements from two of the members of the recreation coalition, the International Snowmobile Industry, and the Recreational Vehicle Dealers Association, which I would like to submit.

Senator LUGAR. Without objection, so ordered.

[Complete statement of Mr. Gilbert and the additional statements referred to follow:]

STATEMENT BY GORDON E. (MIKE) GILBERT, SENIOR VICE PRESIDENT AND MEMBER OF THE EXECUTIVE COMMITTEE OF COACHMEN INDUSTRIES, INC. REPRESENTING THE RECREATION VEHICLE INDUSTRY ASSOCIATION

My name is Mike Gilbert, and I am Senior Vice President and a member of the executive committee of Coachmen Industries, Middlebury, Indiana.

Coachmen manufactures recreational vehicles, boats, mobile homes and accessories for these products. Our company is a very active member of our trade association, the Recreation Vehicle Industry Association, and I am on the RVIA's Finance Committee.

On behalf of my company and the Recreation Vehicle Industry Association, I want to thank you for the opportunity to comment on Senate Bill 1406 and Senate Bill 963.

In addition to the recreation vehicle industry, there are other organizations in the recreational area affected by this legislation. We are all members of the American Recreation Coalition, a group of trade associations and user groups dedicated to the protection and enhancement of every citizen's right to pursue health and happiness through leisure-time activities.

The American Ski Federation, the International Snowmobile Industry Association, the Motorcycle Industry Council, the National Marine Manufacturers Association, the National Spa and Pool Institute, and the Recreation Vehicle Dealers Association are among the organizations that have expressed a high interest in this legislation and have been helpful in focusing attention on the issue before us today.

A policy position statement by the American Recreation Coalition is attached to my comments and I ask that it be submitted for the record.

The members of the Coalition, my company, and the Recreation Vehicle Industry Association wish to recognize and applaud the efforts of the Senators from Arkansas, Senator Bumpers and Senator Pryor, whose measure, S. 963, is also being considered here today. Their efforts are appreciated in view of the unique status of their state regarding availability of credit, but the problem extends to many other states, and we feel that S. 1406 will address their particular problem and also alleviate the problem of credit availability on a national scale.

My main purpose here today is to let you know how the non-availability of consumer credit affects Coachmen Industries and its dealers, and other manufacturer and supplier members of the Recreation Vehicle Industry Association. To use a comic strip analogy, our industry has been hit with a real "triple whammy." The first whammy was the national fear about interruption of our oil supplies and the proposed plan for rationing gasoline and weekend closings which accompanied the

situation. The second, closely related problem has been the increasing price of motor fuel The third and perhaps our most important problem today, has been the squeeze between rising interest rates and state usury law ceilings piled onto the problems of the general economy. This translates into an extremely difficult financing problem for potential recreation vehicle buyers all over the country.

Here is how we've been affected at Coachmen Industries. In 1978, a good year, Coachmen provided employment for 4,800 people—currently we have 2,800 employees; sales volume in 1978 was $305 million, while last year it was $125 million. Our present sales level of $100 million in the first six months of this year—$200 million annualized, includes greater market share plus diversification efforts . . . but we are still well below 1978 levels.

These figures are mirrored by most other recreation Vehicle Industry Association manufacturers and suppliers. Despite belt-tightening and aggressive marketing, most recreation vehicle manufacturers feel frustrated in attempting to market products in the face of state interest rate ceilings below money market rates, thus drastically reducing consumer availability financing. These frustrations and the earnings impact have led to the liquidation of a number of manufacturers in our industry

But possibly even more hard hit than manufacturers, are the franchised dealers distributing our products . . . thousands of small business firms across the country. As an example, Coachmen RV, our largest division, had 448 dealers at the end of 1978. At present, Coachmen RV has 290 dealers, a 35-percent decline. Even more alarming, during this timeframe, Coachmen RV added 160 new dealers, so there has been a 70-percent turnover of our dealers since 1978.

On a national basis, the Recreation Vehicle Dealers Association estimates that the failure rate among dealers has been 47 to 50 percent. This has meant the permanent loss of hundereds of small businesses and thousands of jobs.

RV buyers have a strong credit profile. They consistently have had low delinquency and good repayment records as recorded by the American Bankers Association.

This good record continues, despite the economic recession, as evidenced by the fourth quarter 1980 reports of Bank Delinquency Rates for Installment Loans. RV loans were second with only 2 percent delinquency, compared to the average bank loan of 2.59 percent.

We've never had complaints of retail financing availability until the past eighteen months of sky-rocketing money costs. Now our dealers all across the country are experiencing rejection . . . not for credit reasons . . . but because the bank is no longer making this type of loan . . . or more subtly, the bank will only finance the RV for a customer with an existing bank relationship.

The actual reason for the rejection or tightening is that at the current ceiling rates, the banks or finance companies can't make a profit in view of their money costs.

To a small business, the loss of one or two or more sales a week, due to this credit non-availability, is the difference between profit and loss . . . between keeping afloat or going out of business.

The consumer, too, has been affected.

The origin of the usury statutes was to protect the consumer. The volatile interest rates of the past several years may have made these laws work against the consumer.

First, they dictate the choice of a product or service by denying credit to otherwise qualified customers, rather than letting the customer himself decide whether or not the rates are too high.

Second, in many cases, our dealers are required to pay points to the lender to subsidize the State controlled rate. The dealers increase their price structure to cover the cost of the points, thus raising prices across the board and causing the cash buyer to pay more

Third, with the varying State rates, inequitable competitive situations in markets close to State borders have developed . . . a customer travels across the river or State line for a better price or easier financing simply because of State statutes involved. This seems discriminatory.

Fourth, the decline of dealerships as evidenced by the Coachmen RV Division example, means inconvenience for warranty service with the consumer having to travel many more miles to obtain service than he had anticipated.

As I said, Coachmen and the other RV manufacturers have faced a real triple whammy being sensitive to energy availability, energy costs, and the economy.

We're working through the energy situation with better aerodynamics, lighter components, increased use of diesels, and advanced engineering for products compatible with today's smaller cars. Our customers, too, are quickly adapting to the energy situation and have found the delights of outings closer to home.

But, the sensitivity to the non-availability of credit continues, and we fell helpless. As businessmen, we can't effectively change the statutes of each State with unrealistic consumer credit ceilings.

Senate Bill 1406, introduced by Senator Lugar, is a fair and equitable solution to our problems, and we wholeheartedly support its passage The bill follows the precedent of removing rate ceilings and emphasizes a free market philosophy to which our members heartily subscribe. Perhaps the most compelling reason to pass this legislation is that it reestablishes freedom of choice for the American consumer and the American businessman.

Mr. Chairman, this concludes my formal comments and I will be happy to answer any questions from the Subcommittee.

American Recreation Coalition

Dedicated to the protection and enhancement of every citizen's right to pursue health and happiness through leisure-time activities.

The policy of the American Recreation Coalition on consumer credit supplies and controls is as follows:

Americans testify to the importance of recreation and leisure time pursuits in their lives through their annual expenditure of more than $200,000,000,000 on these pursuits. Many of the expenditures are for recreational items or services of substantial cost for which consumers seek to pay on an extended basis. Such purchases include air vacation fares and cruises as well as pools, boats, RV's, snowmobiles and other consumer durable goods.

Because of the essential role played by recreation in today's fast-paced world, the availability of financing for recreation and recreation-related expenses is of great importance. The American Recreation Coalition therefore supports public and private actions which facilitate the availability of consumer financing for recreation purposes.

In recent years, the supply of consumer credit has been reduced and its cost increased by massive levels of federal government borrowing, made necessary by continuing large government budget deficits. The American Recreation Coalition believes that this borrowing -- in direct competition with American taxpayers' own credit needs -- must be restrained. To do so, the federal budget must be reduced and a balance must be achieved between federal revenues and expenditures.

The availability of consumer credit has also been jeopardized by state usury laws which impose unrealistic limits on interest rates for consumer borrowing. While designed to protect consumers, these laws have proven to be too inflexible and have actually worked against consumers' interests. The American Recreation Coalition therefore supports laws at the federal and state levels which provide reasonable, flexible and competitive limits on consumer credit costs.

ADOPTED MARCH 19, 1981

14650 Lee Road • Chantilly, Virginia 22021 • (703) 968-7728

AMERICAN RECREATION COALITION

American Camping Association
American Horse Council
American Hotel and Motel Association
American Land Development Association
American Motorcyclist Association
American Power Boat Association
American Recreational Equipment Association
American Ski Federation
American Water Ski Association
American Youth Hostels, Inc.

Boating Trades Association of Texas

Champion Fleet Owners Association
Colorado Campground Association
Connecticut Marine Trades Association

Experimental Aircraft Assn.

Family Motor Coach Association
Federation of Outdoor Recreationists
Foremost Insurance Company

Good Sam (camping) Club

Holland (Michigan) Motor Homes, Inc.

Institute for Career and Leisure Development
Intercoastal (golf cart) Manufacturing Company, Inc.
International Assn. of Amusement Parks & Attractions
International Kart Federation
International Snowmobile Council
International Snowmobile Industry Association
Intra-South (recreation) Publications, Inc.

Kampgrounds of America
Kampground Owners of America

Leisure Systems, Inc.

Marine Retailers Association of America
Michigan Boating Industries Association
Michigan Mobile Home and Recreational Vehicle Institute
Motorcycle Industry Council
Motorhome Travelers Association

National Association of Property Owners
National Campers and Hikers Association
National Campground Owners Association
National Federation of State High School Assns.
National Forest Recreation Association
National Hot Rod Association
National Industrial Recreation Association
National Marina Association
National Marine Manufacturers Association
National Motor Sports Committee
National Outdoor Coalition
National Retired Teachers Assn./American Assn. of Retired Persons
National Spa & Pool Institute
North American Family Campers Assn. Inc.
NRA Institute for Legislative Action

Outdoor Resorts of America, Inc.

Pony Baseball, Inc.

Recreation Vehicle Club Directors Association
Recreation Vehicle Dealers Association
Recreation Vehicle Industry Association
Roller Skating Rink Operators Association

Southern California Loners on Wheels
Southern California Marine Association
Special (handicapped) Recreation, Inc.
Specialty Equipment Market Association
Sporting Goods Business Magazine
Starcraft Owners Club

United Four Wheel Drive Association
United (recreational shows) Promotions, Inc.

Wally Byam Caravan Club International
Warehouse Distributors Assn. for Leisure and Mobile Products

TESTIMONY ON S. 1406 BEFORE THE
FINANCIAL INSTITUTIONS SUBCOMMITTEE
U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
BY THE INTERNATIONAL SNOWMOBILE INDUSTRY ASSOCIATION
JULY 9, 1981

The International Snowmobile Industry Association is the representative of manufacturers of snowmobiles throughout the world, plus manufacturers of key components used in the production of snowmobiles. Currently there are an estimated 1.8 million snowmobiles in operation in the United States, used by an estimated 12,000,000 Americans primarily for recreation. However, these vehicles are also actively used for many utilitarian purposes as well, from rescue work to feeding livestock on farms in snow conditions. New snowmobiles today range in cost from $1,000 to more than $4,000, and are sold by a network of some 5,000 dealers.

Last season, sales of new snowmobiles in the United States declined sharply because of poor snow cover and poor economic conditions. The drop was 43% from the level of 1978-1979.

Obviously, consumer lending rate limitations were not the primary cause for this drop; without snow, opportunities for snowmobile usage are limited. However, both during the 1979-80 and 1980-81 selling seasons, our industry's dealers experienced very real roadblocks to financing new snowmobiles in specific markets, difficulties which proved costly to a seasonal industry such as ours. The difficulties included outright inaccessibility of loans from traditional sources caused by state limits on lending rates and overall tightness in consumer lending.

In several instances, problems experienced by potential buyers of new snowmobiles forced ISIA member companies to develop special snowmobile financing packages involving loan rate buy-downs, recourse provisions and other programs. Obviously all of these efforts cost money and this cost will ultimately be recovered from the consumer. Although we are unable to document the conclusion that this indirect cost will ultimately be higher to our customers, we believe it may well be.

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S. 1406 can be helpful to American consumers. It offers a mechanism for expediently and efficiently removing unrealistic limits on consumer loans enacted by state governments during a far different financial climate. It also eliminates the requirement fo unnecessarily complex and costly mechanisms which have been developed to overcome these limitations by lenders, sellers and others. We are pleased to endorse the position taken by the Recreation Vehicle Industry Association (RVIA) and the position of the American Recreation Coalition on consumer credit supplies and controls, a copy of which is attached.

WRITTEN COMMENTS
ON
CREDIT DEREGULATION AND AVAILABILITY ACT
OF 1981 (S-1406)

by

RECREATION VEHICLE DEALERS ASSOCIATION
OF
NORTH AMERICA

The Recreation Vehicle Dealers Association of North America (RVDA) is composed of dealer members who sell at retail recreation vehicles, namely, travel trailers, motorhomes, pick-up campers and folding trailers. These vehicles commonly know as RVs or Family Camping vehicles are all licensed for highway travel and provide temporary living shelter when in use.

During 1979 and 1980 it is estimated some 2,000 RV dealerships either voluntarily or involuntarily closed their doors. This represents about 45% or more of the known RV dealer base. While much of this loss can be attributed to discriminatory actions of the government through the Department of Energy, the extreme vacillation of interest rates also was involved. This was particularly true with the availability of retail financing.

Family camping does not appeal to everyone but for many who enjoy the outdoors it becomes an economical way to travel, particularly for households with children. The RV product line includes vehicles priced from about $2,700 to over $100,000 and incorporating living amenities from spartan to luxurious. Some multi-year financing is a necessity for many purchasers just like an automobile, a boat or a small cottage or cabin.

The economy of the United States is going through some trying times as various efforts to combat inflation are used, particularly the actions of the Federal Reserve Board and the availability of money. RVDA is not large enough to have its own economist and its members would probably question the projections of that person just like all of the others who try to make some sense out of a very complicated financial morass. The actions of the Federal Reserve are necessary and laudable but have resulted in sharper interest rate variations that this country has ever experienced. All of this has created uncertainty as to any financing beyond one year.

(continued)

This concern for what will happen in two years, three years or more has been compounded by the many state restraints on allowable interest rates. Originally enacted to theoretically protect the consumer, these usury ceilings have instead prevented many qualified would-be purchasers from buying simply because financing was not available. The financial changes in the past two years have been too rapid and too extreme for many of the states to make corresponding changes in their laws. This unavailability of financing comes in spite of the fact that RV purchasers have consistently maintained the second, third or fourth best record of performance among the ten areas of installment lending which the American Banking Association follows regarding delinquencies.

The Recreational Vehicle industry and particularly the RV dealer portion can ill afford any additional burdens at this time. Unfortunately the small businesses already gone cannot be brought back. Further losses should not be countenanced for other than poor individual business decisions. Since the economy is undergoing many changes and since it is expected there will be uncertainties involved for the next few years as hopefully the spectre of inflation diminishes, RVDA supports S-1406 as a means of bringing some stability at this time to the availability of financing.

Mr. GILBERT. My company, Coachmen Industries, and the other manufacturers and supplier members of RVIA have been hit by a real triple whammy. First, the national fear of the interruption of oil supplies, the projected gasoline shortages, weekend closings, et cetera. Second, the increasing price of motor fuel. Now piled onto the problems of the general economy, we have the squeeze between rising interest rates and the State usury ceilings.

DIFFICULT FINANCING PROBLEMS

This translates into nonavailability of consumer credit, and extremely difficult financing problems for potential recreational vehicle buyers all over the country.

Here's how we've been affected at Coachmen. In 1978, we had 4,800 employees; now, 2,800. Sales volume in 1978 was $305 million; last year, $125 million. This year, due to diversification and a greater market share, we had $100 million in the first 6 months, but that's still well below 1978.

Other manufacturers have had similar experiences, and many have liquidated. The franchise dealers distributing our products may have been even more hard hit. As an example, Coachmen RV, our largest division, had 448 dealers at the end of 1978; now, 290—down 35 percent.

Even more concerning has been a 70-precent dealer turnover in this division since 1978. On a national basis, 47 to 50 percent of the RV dealers have failed or liquidated, according to the RV Dealers Association.

RV buyers have a good credit profile, with low delinquency and good repayment records, according to the American Bankers Association. This good record continues, despite the recession. RV loans had the second lowest delinquency record among all consumer loan categories in the fourth quarter 1980 ABA report.

There have never been complaints of retail financing availability until the past 18 months of skyrocketing money costs. Now, dealers all across the country are experiencing rejections—not for credit, but because banks are no longer making these loans, or are limiting the type of loan to existing customers. They are tightening, simply because of unprofitability to the bank, at the rates that can be charged.

To a small business, the loss of one, two, or more sales a week, due to this credit nonavailability, is the difference between profit and loss, between keeping afloat or going out of business.

The volatile interest rates of the past several years seem to make the usury statutes work against, instead of for, the consumer. They dictate the choice of a product by denying credit to otherwise qualified customers, rather than letting the customer decide whether or not the rates are too high.

Dealers pay points to lenders, to subsidize the State-controlled rates, increasing prices across the board, to cover the cost of points. So, cash buyers pay more. Inequitable competitive situations spring up in communities near State lines, due to the different State laws, which seems discriminatory. Dealership decline and turnover causes customers warranty service inconvenience.

We are adapting to the energy situation with product changes, to light-weight, fuel-efficient products. Our customers are adapting to the energy situation with the delights of outings closer to home. Sensitivity of nonavailability of credit continues, and as businessmen, we feel helpless. We can't effectively change the States' statutes.

Senate bill 1406, introduced by you, Mr. Chairman, is a fair and equitable solution to our problems, and we wholeheartedly support its passage. The bill follows a precedence of removing rate ceilings, and emphasizes a free market philosophy to which our members subscribe.

Perhaps the most compelling reason to pass this legislation is that it reestablishes the freedom of choice for the American consumer and the American businessman.

That concludes my formal comments.

Senator LUGAR. Thank you very much, Mr. Gilbert.

The Chair would now like to call upon Mr. Miller.

Mr. MILLER. Thank you, Mr. Chairman.

My name is Wendell Miller and I am a Lincoln-Mercury, Dodge, and Honda dealer from Binghamton, N.Y., and president of our National Automobile Dealers Association, NADA. I speak for the over 20,000 new car and truck dealers, both domestic and import, in our association. We welcome the opportunity to be here and testify on S. 1406, the Credit Deregulation and Availability Act of 1981, and S. 963, which is so important to our dealers in Arkansas. The concern that you and the other members of this committee have expressed over the issue of high interest rates and the compounding problem of State usury statutes is certainly appreciated by the entire dealer body.

Mr. Chairman, this is the third time since January that we have testified before members of the Banking Committee on high interest rates and related problems. We hope this hearing will be the

beginning of the elimination of one of these problems, outdated State usury laws.

The problems of the automobile industry are well documented, and I won't go into a detailed review right now. But 2,000 dealers have closed their doors in the past 18 months, and approximately 125,000 of their employees are out of work.

INDUSTRY FACES UNPRECEDENTED FINANCIAL CRISIS

Our domestic industry continues to face an unprecedented financial crisis. There are a number of reasons behind the recent decline of our industry, but the major contributing factor, dwarfing all others, is high interest rates. During periods when interest rates reach exorbitant levels, dealers are burdened with high financing costs at precisely the time when customer sales are stagnating. It's this combination of high overhead costs and low retail sales that leads to bankruptcy.

Compounding the high interest rate problem is the problem of the State usury laws. Those consumers who desire credit and can afford higher rates simply cannot get credit in States where the usury limits fall well below the prime rate.

During times of high interest, financial institutions which are restricted by State usury ceilings either reduce significantly or stop the financing of high-ticket consumer items, such as automobiles. The American Bankers Association, in testimony before a House subcommittee, stated that "automobile dealers, despite aggressive marketing, were frustrated in their attempts to reduce high inventories, due partially to the inability of consumers to obtain automobile loans."

Moreover, in certain instances, banks agreed to floorplan inventory in anticipation of receiving the dealer's retail business. If banks no longer intend to finance consumer contracts, the incentive to engage in wholesale financing is also removed.

Traditionally, the dealer's main financing source handled the wholesale financing, the financing of wholesale inventory, to get the retail business. In the past 2 years, it's been just the opposite. Banks and our captive finance industries are, in effect, giving the retail business to get the wholesale business.

In an article entitled "Rising Prime Rate Plus State Usury Ceilings Put a Kink in Car Industry's Recovery Outlook," which appeared in the Wall Street Journal, an analyst at A. G. Becker, Inc., estimated "that a prime rate of 18½ percent makes personal auto loans 'unattractive' to banks, because of usury laws limitations in 36 States. Those States accounted for about 60 percent of all auto sales last year." While several States have since revised upward their usury limits, 25 States still have interest rate ceilings on automobile credit of 18 percent or less.

NADA estimates that approximately 30 percent of all consumer retail finance contracts are being turned down by financial institutions. This is a pretty consistant figure over the last 2 or 3 years. A reference to a 50-percent turndown rate was mentioned by Senator Bumpers this morning. Actually this was situation which has existed, but it was for a short period, when the prime was at a peak level.

In most cases, the inability of a bank to charge the going rate, and not the creditworthiness of the individual, has resulted in a refusal to extend credit.

COMMERCIAL BANKS LEAVING AUTO FINANCING BUSINESS

As commercial banks have gotten out of the auto financing business, the finance companies of the domestic auto manufacturers, which we refer to as captive finance companies, have had to take up the slack. The shift in the issuance of automobile paper from commercial banks to the finance companies is significant, as demonstrated by the attached table to the report which I have submitted.

Table I simply shows the percentage of automobile paper extensions by the type of lender for the decade of the 1970's. The decade average indicates that approximately 60 percent of the consumer contracts for automobiles purchased were issued, either directly or indirectly, by commerical banks. By contrast, finance companies accounted for about 20 percent of total automobile contracts.

If you turn to table II, we find commercial banks in 1980 issued an average of 12 percent less automobile paper than in the 1970's, with the finance companies picking up the difference. But even more disturbing, the first month of this year witnessed a decline in auto extensions by banks to a mere 36 percent of the total number of contracts issued.

In the 1970's, the banks were 60 percent and the finance companies 20. It's now reversed, and for the first month the finance companies are handling a higher percentage of the automobile paper than the banks are.

The liability for dealers when banks terminate consumer financing of automobiles is threefold:

First, the dealer could find himself without any source of financing if he does not have a captive finance corporation to turn to—General Motors Acceptance, Chrysler Credit, Ford Motor Credit.

Second, even if a captive finance corporation is available, there are limits on that corporation's ability to finance the ever-increasing number of contracts being presented to them.

And third, the competitive atmosphere between the traditional providers of automobile financing is diluted significantly. By removing usury ceilings for consumer credit, NADA believes competition would again return to the marketplace, benefiting both dealers and their customers.

The most graphic example, of course, of the adversity caused by outdated usury laws occurs in Arkansas. Arkansas dealers are present, and I will defer to them for an explanation of specific problems they have experienced.

It's important, however, to note that the problems experienced in Arkansas are not limited to Arkansas. And it is for this reason that NADA strongly supports the efforts of your bill, Senator, in S. 1406.

The Congress established a precedent for preempting State usury laws in the Depository Institutions Deregulation and Monetary Control Act of 1980. In that act, State usury ceilings were preempted for business and agricultural loans. NADA believes Congress

must now address the usury question and preempt State usury ceilings for consumer credit, as called for in S. 1406.

A deregulation of credit limits, as outlined in S. 1406, should provide more competition among the various lending institutions and encourage those traditional providers of automobile and truck loans to return to the marketplace in those areas where they have been forced to leave.

With respect to S. 963, NADA recognizes the unique political situation in Arkansas and applauds Senators Bumpers and Pryor for trying to help mitigate a truly desperate situation there. Nevertheless, this is a nationwide problem and calls for a nationwide solution, as incorporated in S. 1406.

Mr. Chairman, the preemption of State usury laws is not a total panacea for our industry. But it is a major action which will have a positive impact on all automobile and truck sales.

We appreciate this opportunity to testify before you, and we'd be happy to answer any questions. Thank you.

[Complete statement follows:]

STATEMENT OF

WENDELL H. MILLER, PRESIDENT

NATIONAL AUTOMOBILE DEALERS ASSOCIATION

Mr. Chairman, my name is Wendell H. Miller and I am a Lincoln-Mercury, Dodge and Honda dealer from Binghamton, New York and President of the National Automobile Dealers Association (NADA).

On behalf of the approximately 20,000 new car and truck dealer members of NADA, I sincerely welcome the opportunity to testify before your Subcommittee on S. 1406, the "Credit Deregulation and Availability Act of 1981," and S. 963. The concern that you and other members of the Committee have expressed over the issue of high interest rates and the compounding problem of state usury statutes is appreciated by the entire dealer body.

Mr. Chairman, this is the third time since January that NADA has testified before members of the Banking Committee on high interest rates and related problems. We hope that this hearing will be the beginning of the elimination of one of these problems, outdated state usury laws.

The problems of the automobile industry are well documented and I will not go into a detailed review of them at this time. However, a brief review of the plight of the franchised dealer over the past 18 months reveals staggering losses. Over 2,000 dealers have closed their doors, and well over 125,000 dealership employees have lost their jobs. Suffice it to say that the domestic industry continues to face an unprecedented financial crisis.

While there are a number of reasons behind the industry's recent decline, clearly a major contributing factor is high interest rates. During periods when interest rates reach exorbitant levels, dealers are burdened with high inventory financing costs at precisely the time when customer sales are stagnating. It is this condition of high overhead costs and low retail sales that leads to bankruptcy.

Juxtaposing the high interest rate problem is the problem of state usury laws. Usury limits compound the problems of small businessmen who are already hurt by the increased costs of doing business. Additionally, those consumers who desire credit and can afford higher rates simply cannot get credit in states where usury limits fall well below the prime rate.

During times of high interest, financial institutions which are restricted by state usury ceilings either reduce significantly or stop altogether the financing of high ticket consumer items such as automobiles. The American Bankers Association, in testimony before a House Subcommittee on August 26, 1980, stated that " . . . automobile dealers, despite aggressive marketing, were frustrated in their attempts to reduce high inventories due partially to the inability of consumers to obtain automobile loans."

Moreover, in certain instances banks agree to floorplan dealer inventory in anticipation of receiving the dealer's retail business. If banks no longer intend to finance consumer contracts, the incentive to engage in wholesale financing is also removed.

In an article entitled "Rising Prime Rate Plus States' Usury Ceilings Put a Kink in Car Industry's Recovery Outlook," which appeared in the December 3, 1980 issue of the Wall Street Journal, an analyst at A.G. Becker, Inc. estimated "that a prime rate of 18 1/2% makes personal auto loans 'unattractive' to banks, because of usury law limitations, in 36 states. Those states accounted for about 59% of all auto sales last year." While several states have since revised upward their usury limits, some 25 states still have interest rate ceilings on automobile credit of 18% or less.

NADA estimates that approximately 30% of all consumer retail finance contracts are being turned down by financial institutions. In many cases,

the inability of a bank to charge the going rate, and not the credit worthiness of an individual, has resulted in a refusal to extend credit.

As commercial banks have gotten out of the auto financing business, the finance companies of the domestic auto manufacturers have had to take up the slack. The shift in the issuance of automobile paper from commercial banks to the finance companies is significant, as demonstrated by the attached tables.

Table I shows the percentage of automobile paper extensions by type of lender for the decade of the '70's. The decade average indicates that approximately 60% of the consumer contracts for automobile purchases were issued, either directly or indirectly, by commercial banks. By contrast, finance companies accounted for about 20% of total automobile contracts.

Turning to Table II, we find that commercial banks in 1980 issued an average of 12% less automobile paper than in the 1970's, with the finance companies picking up the difference. Even more disturbing, the first month of this year witnessed a decline in auto extensions by banks to a mere 35.9% of the total number of contracts issued.

The liability for dealers when banks terminate consumer financing of automobiles is three-fold. First, the dealer could find himself without a source of financing, if he does not have a finance corporation to turn to. Second, even if a finance corporation is available, there are limits on the corporation's ability to finance the ever increasing number of contracts being presented to them. And third, the competitive atmosphere between the traditional providers of automobile financing is diluted significantly. By removing usury ceilings for consumer credit, NADA believes competition would again return to the marketplace, benefiting both dealers and consumers.

The most graphic example of the adversity caused by restrictive usury laws comes in Arkansas. Since Arkansas dealer representatives are present, I will defer to them for an explanation of specific problems they have experienced. It is important to note, however, that the problems experienced in Arkansas are not necessarily limited to Arkansas. And it is for this reason that NADA strongly supports the efforts of Senator Lugar in S. 1406.

The Congress established a precedent for preempting state usury laws in the Depository Institutions Deregulation and Monetary Control Act of 1980. In that Act state usury ceilings were preempted for business and agricultural loans. NADA believes that the Congress must now readdress the usury question and preempt state usury ceilings for consumer credit, as called for in S. 1406. The deregulation of credit limits outlined in S. 1406 should provide more competition among the various lending institutions and encourage those traditional providers of automobile and truck loans to return to the marketplace in those areas where they have been forced to leave.

With respect to S. 963, NADA recognizes the unique political situation in Arkansas and applauds Senators Bumpers and Pryor for trying to help mitigate a truly desperate situation. Nevertheless, this is a nationwide problem and calls for a nationwide solution, as incorporated in S. 1406.

Mr. Chairman, the preemption of state usury laws is not a panacea for our industry. It is, however, an action which will have a positive impact on automobile and truck sales.

NADA appreciates this opportunity to testify before your Committee, and I will be happy at this time to answer any questions you may have.

TABLE I

AUTOMOBILE PAPER

EXTENSIONS BY TYPE OF LENDER, 1970-1979

(Percent of Total)

	Commercial Banks			Credit Unions	Finance Companies
	Total	Indirect	Direct		
1979	55	31	24	20	25
1978	60	33	27	22	19
1977	61	33	28	22	17
1976	59	32	27	23	18
1975	57	32	26	24	18
1974	60	35	25	22	18
1973	62	37	25	18	19
1972	61	36	26	18	21
1971	62	36	26	14	24
1970	62	38	23	14	24
Decade Average	59.9	34.3	25.7	19.7	20.3

Source: Board of Governors of the Federal Reserve System, NADA Research Division

TABLE II

AUTOMOBILE PAPER

EXTENSIONS BY TYPE OF LENDER - 1980

(Percent of Total)

	Commercial Banks			Credit Unions	Finance Companies
	Total	Indirect	Direct		
Jan.	50.8	27.6	23.2	21.8	27.4
Feb.	54.0	29.4	24.6	15.8	30.2
March	46.9	27.3	19.6	18.0	35.1
April	41.9	25.0	16.9	16.8	41.3
May	45.3	26.1	19.3	16.1	38.5
June	45.3	22.9	22.4	14.8	39.9
July	49.0	24.9	24.1	17.8	33.2
Aug.	50.2	27.2	23.0	17.6	32.2
Sept.	50.9	27.5	23.4	18.7	30.4
Oct.	50.3	28.3	22.0	19.3	30.4
Nov.	49.9	27.6	22.3	19.7	30.4
Dec.	45.2	25.7	19.5	21.3	33.5
Monthly Average	48.3	26.6	21.7	18.1	33.5
1/81	35.9	17.0	18.9	22.0	42.1

Source: Board of Governors of the Federal Reserve System, NADA Research Division

Senator LUGAR. Thank you for coming again to the committee this morning, Mr. Miller.

The Chair would like to call now upon Mr. Chalmers from Arkansas.

Mr. CHALMERS. Thank you, Mr. Chairman.

I will make my remarks as brief as possible.

Mr. Chairman and members of the committee, my name is Hugh B. Chalmers. I am a Chevrolet-Toyota dealer from West Memphis, Ark., and I am currently president of the Arkansas Automobile Dealers Association, representing approximately 400 automobile dealers in Arkansas.

I sincerely thank you for this opportunity to testify before you today on behalf of Senate bill No. 963, which will partially resolve the most critical situation in our State.

I want to make three points:

First, to present the status of interest rates and the basic inequities within the consumer field in Arkansas today;

Second, to show the plight of the automobile dealer, who has to operate under these inequities and who is representative of most of the retail merchants in the State; and

Third, to show the severe negative impact on the Arkansas consumer when his choice is limited because competition is greatly restricted due to inequitable consumer-lending interest rates.

MOST RESTRICTIVE INTEREST LIMITATION IN THE UNION

Arkansas presently has the most restrictive interest limitation of any State in the Union embedded in its constitution of 1874, which we have already discussed at length. I'd like to summarize those comments in making this statement.

Not only is the interest lost in the violation of that 10-percent, but the principal is also forfeited, which makes that 10-percent limitation so much more abrasive.

The Arkansas Supreme Court has continued over the years to give the word "interest" the broadest possible interpretation. And summarizing on that point, in short, the Arkansas Supreme Court has stated whatever is not principal is interest, and 10 percent is all that is allowable.

Presently, there are several efforts being made to change this 107-year-old restriction. And we've discussed those earlier:

The legislative referendum that would be voted on by the people in November 1982. And also, there's pending litigation before the U.S. Supreme Court which hopes to have the 10-percent limitation declared unconstitutional as a restriction to interstate commerce and a denial of the due process of law.

However, these ongoing pursuits cannot give the needed relief quickly enough.

It is not difficult to deduct the hardship incurred by the Arkansas automobile dealer, who is forced to operate under a 10-percent Arkansas usury limitation, even though national and international forces are responsible for the prime rate recently exceeding the 20-percent level, the Fed funds market spirally to 23 percent recently, and the Nation being in a double-digit inflationary rate.

In 1980, Congress, sensitive to the financial community's needs, enacted the Depository Institutions Deregulation and Monetary

Control Act. This legislation meant economic survival for many lenders in Arkansas, specifically federally related financial institutions. The act was broad enough to allow greater interest rates for business and agricultural loans. What this act did not do was provide an equitable remedy for the retail sector in the form of needed interest rate adjustments for nonbanking lenders.

The banking institutions were given relief under the 1980 legislation, but the retail merchant in Arkansas is still mandated to operate under a 10-percent usury limitation.

The impetus which prompted Federal legislation in 1980, giving relief to the banking institutions in Arkansas, is needed even more today by the Arkansas retail merchant. He must go outside the banking community for most of his lending needs, because he is responsible for the majority of the consumer installment lending in this State.

DEALERS DEPEND ON CAPTIVE FINANCE COMPANIES

Historically, the Arkansas automobile dealer has had to depend on the "captive" finance company to help consumers finance their purchases of automobiles. These "captive" finance companies of the manufacturers—GMAC, Ford Motor Credit, and Chrysler Credit—even though they still provide most of the financing to consumers, were not included in the 1980 Monetary Control Act.

Since they operate under the restrictive Arkansas 10 percent maximum, they have been forced to constrict their credit policies severely and transfer the exposure involved in consumer lending to the dealers they finance. This has resulted in the Arkansas automobile dealer accepting full responsibility for all financed sales. The dealer now has full recourse, without any protection from collision, conversion, or confiscation losses.

A dealer is also required to deposit a finance reserve out of the proceeds of the finance contract with the finance company. In the case of GMAC, in Arkansas it limits its financing only to General Motors new vehicles and only to the first trade-in on the sale of that new GM product.

New car dealers who are not General Motors, Ford, or Chrysler franchised, and therefore do not have the advantage of a "captive" finance company, find themselves in a dire situation. This is especially true of the import auto dealers. If their customers are unable to pay cash for their purchases, they must be a good customer of a bank in order to qualify for financing.

Several years ago, all those finance companies that were not associated with a manufacturer ceased operations in Arkansas. Slowly, the availability of credit has been reduced to that of the banking community and the "captive" finance companies.

Even though the banking institutions can charge a consumer-lending rate of 1 percent over the rediscount rate, they restrict their consumer-lending activities to their customers with active bank accounts.

The Federal remedy, which now allows Arkansas bank accounts to charge up to 23 percent on larger commercial loans, has caused them to place a low priority on consumer loans that require more attention and have higher costs when they yield only 1 percent over rediscount rate. This has, in effect, placed an unreasonable

credit burden on the consumer's ability to secure credit for all of his needs, including transportation.

Senate bill No. 963 proposes to correct the unfair and discriminating situation created for consumer credit in Arkansas by the 1980 Depository Institutions Deregulation and Monetary Control Act, however well it was intended. Banking institutions now have greater flexibility in their operations, even though they are under the same constitution which governs the automobile dealer.

This has established two consumer lending policies, neither of which is acceptable, and has created a financial plight of the most severe degree that presently threatens the survival of many businesses, long before a general election or a Supreme Court decision can rectify the problem.

These deduction are, however, of a financial and analytical nature, however, when one juxtaposes the hardship this causes citizens who reside in the State of Arkansas, citizens who require transportation as a basic necessity to get to a job in order to earn a living for their families or, in cases of emergency, to get their families to a doctor.

The Arkansas resident who has any credit problems of any type in his credit history is unable to secure financing at the 10-percent rate, and because of the banks' highly restrictive consumer-lending policy, a vacuum has been created that denies many buyers their ability to purchase.

If a buyer of limited credit is forced, out of necessity, to purchase an automobile, he finds himself at the mercy of some, not all, used car dealers, who, by charging exorbitant prices, especially on older cars, can overcome the restrictions of the 10-percent interest by carrying the financing themselves.

In cases like this, which are not few, the lower income consumer gets caught. The consumer's choice is limited, and practically speaking, a 10-percent interest rate becomes no credit at all.

Ironically, the law—meaning the constitution of 1874 that established the 10 percent—that was intended to protect the consumer provides the opportunity for taking advantage of him.

CASH BUYER SUBSIDIES CREDIT BUYER

A study done several years ago about Arkansas' 10-percent limitations concluded that the cash buyer subsidizes the credit buyer in Arkansas, because the cost of goods is elevated to cover the cost of financing. While the Arkansas dealer is today hard-pressed as a result of the 10-percent Arkansas interest rate, the real loser is the consumer.

The finance companies that have been willing to offer the consumer the credit he needs cannot, because they cannot afford the cost of lending. They were not included in the 1980 legislation that was promoted as a remedy for the State's financial problems. If we place the consumer's plight on an equal footing in importance with the plight of the financial institutions, we will change this situation which presently denies competition and free choice.

Simply put, where banks choose, they can legally charge 15 percent for the same loan that GMAC is legally restricted to 10 percent. There is something wrong with allowing an inequity to exist which denies any credit to many consumers.

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Senate bill No. 963 will not open the consumer credit market to the total freedom needed, but it will temporarily stop the serious threat to survival of many Arkansas small businessmen and afford credit to those consumers who need it most.

Lastly, as a response to those who feel sensitive to injecting a congressional remedy to a State's internal problems, may I respectfully restate that the conditions that have caused this problem have come from outside the borders of Arkansas.

Your previous involvement in past legislation was in favor of a particular segment of the Arkansas economy, in preference to the rest of the consumer installment credit sector.

What Congress has done for business needs should now be extended to the consumer.

I will be most happy to answer any questions you might have.

[Complete statement follows:]

Statement of Hugh B. Chalmers
President, Arkansas Automobile Dealers Association
Before the Senate Subcommittee on Financial Institutions
July 9, 1981

Mr. Chairman, Members of the Committee, my name is Hugh B. Chalmers. I am a Chevrolet-Toyota dealer from West Memphis, Arkansas, and I am currently president of the Arkansas Automobile Dealers Association, representing approximately 400 automobile dealers in Arkansas.

I sincerely thank you for this opportunity to testify before you today on behalf of Senate Bill #963, which will partially resolve the most critical situation in our state.

I want to make three points: first, to present the status of interest rates and the basic inequities within the consumer field in Arkansas today; second, to show the plight of the automobile dealer, who has to operate under these inequities and who is representative of most of the retail merchants in the state; and, third, to show the severe negative impact on the Arkansas consumer when his choice is limited because competition is greatly restricted, due to inequitable consumer-lending interest rates.

Arkansas presently has the most restrictive usury limitation of any state in the union embedded in its constitution of 1874. This 107 year old constitutional limitation of 10% carries the most severe penalties for both intentional and unintentional violations: not only is the interest lost, but the principle is also forfeited.

The Arkansas Supreme Court has continued, over the years, to give the word 'interest' the broadest possible interpretation. 'Interest' has now been held to include virtually every type of charge or fee associated with the lending of money, such as commitment fees, loan guarantees, mandatory charges for credit life insurance, time-price differentials, and all [illegible] incurred by a lender and passed on to the borrower in the ordinary course of consummating a loan or credit transaction. In short, whatever is not principal is interest, and 10% is all that is allowable. While this 10% interest has been difficult to live with in the past, today this restriction threatens the very existence of many Arkansas businesses.

Presently there are several efforts being made to change this 107 year old restriction. There is a legislative referendum to be voted on by the people in November, 1982, to correct this problem. Also, there is pending litigation in an appeal to the United States Supreme Court, which hopes to have the 10% limitation declared unconstitutional as a restriction to interstate commerce and a denial of due process of law. However, these on-going pursuits cannot give the needed relief quickly enough.

It is not difficult to deduct the hardship incurred by the Arkansas automobile dealer, who is forced to operate under a 10% Arkansas usury limitation, even though national and international forces are responsible for the prime rate recently exceeding 20%, the fed funds market spiraling to 23%, and the nation being in a double digit inflationary rate.

In 1980, Congress, sensitive to the financial community's needs, enacted the Depository Institutions Deregulation and Monetary Control Act. This legislation meant economic survival for many lenders in Arkansas, specifically federally related financial institutions. The act was broad enough to allow greater interest rates for business and agricultural loans. What this act did NOT do was provide an equitable remedy for the retail sector in the form of needed interest rate adjustments for non-banking lenders. The banking institutions were given relief under the 1980 legislation, but the retail merchant in Arkansas is still mandated to operate under a 10% usury limitation.

The impetus which prompted federal legislation in 1980, giving relief to the banking institutions in Arkansas, is needed even more today by the Arkansas retail merchant. He must go outside the banking community for most of his lending needs, because he is responsible for the majority of the consumer installment lending.

Historically, the Arkansas automobile dealer has had to depend on the "captive" finance company to help consumers finance their purchases of automobiles. These"captive" finance companies of the manufacturers -- GMAC, Ford Motor Credit and Chrysler Credit -- even though they still provide most of the financing to consumers, were not included in the 1980 Monetary Control Act. Since they operate under the restrictive Arkansas 10% maximum, they have been forced to constrict their credit policies severely and transfer the exposure involved in consumer lending to the dealers they finance. This has resulted in the Arkansas automobile dealer accepting full responsibility for all financed sales. The dealer

now has full recourse without any protection from collision, conversion or confiscation losses. A dealer is also required to deposit a finance reserve out of the proceeds of the finance contract with the finance company. In the case of GMAC, in Arkansas it limits its financing only to General Motors new vehicles and only to the first trade-in on the sale of that new GM product.

New car dealers who are not General Motors, Ford, or Chrysler franchised, and, therefore, do not have the advantage of a "captive" finance company, find themselves in a dire situation. This is especially true of the import auto dealers. If their customers are unable to pay cash for their purchases, they must be a good customer of a bank in order to qualify for financing. Several years ago, all those finance companies that were not associated with a manufacturer ceased operations in Arkansas. Slowly the availability of credit has been reduced to that of the banking community and the "captive" finance companies.

Even though the banking institutions can charge a consumer-lending rate of 1% over the re-discount rate, they restrict their consumer-lending activities to their customers with active bank accounts. The federal remedy, which now allows Arkansas banks to charge up to 22% on larger commercial loans, has caused them to place a low priority on consumer loans that require more attention and have higher costs when they yield only 1% over re-discount rate. This has, in effect, placed an unreasonable credit burden on the consumer's ability to secure credit for all of his needs, including transportation.

Senate Bill #963 proposes to correct the unfair and discriminating situation created for consumer credit in Arkansas by the 1980 Depository Institutions Deregulation and Monetary Control Act, however well it was intended. Banking institutions now have greater flexibility in their operations, even though they are under the same constitution which governs the automobile dealer. This has established two consumer lending policies, neither of which is acceptable and has created a financial plight of the most severe degree that presently threatens the survival of many businesses, long before a general election or a Supreme Court decision can rectify the problem.

These deductions are of a financial and analytical nature, however, when one juxtaposes the hardship this causes citizens who reside in the state of Arkansas, citizens who require transportation as a basic necessity to get to a job in order to earn a living for their families, or, in cases of emergency, to get their families to a doctor.

The Arkansas resident who has any credit problems of any type in his credit history is unable to secure financing at the 10% rate, and, because of the banks' highly restrictive consumer-lending policy, a vacuum has been created that denies many buyers their ability to purchase. If a buyer of limited credit is forced, out of necessity, to purchase an automobile, he finds himself at the mercy of a used car dealer who, by charging exorbitant prices, especially on older cars, can overcome the restrictions of the 10% interest by carrying the financing himself. In cases

like this, which are not few, the lower income consumer gets caught. The consumer's choice is limited, and, practically speaking, a 10% interest rate becomes no credit at all. Ironically, the law that was intended to protect the consumer provides the opportunity for taking advantage of him.

A study done several years ago about Arkansas' 10% limitations concluded that the cash buyer subsidizes the credit buyer in Arkansas, because the cost of goods is elevated to cover the cost of financing. While the Arkansas dealer is today hard pressed as a result of the 10% Arkansas interest rate, the real loser is the consumer.

The finance companies that have been willing to offer the consumer the credit he needs cannot, because they cannot afford the cost of lending; they were not included in the 1980 legislation that was promoted as a remedy for the state's financial problems. If we place the consumer's plight on an equal footing in importance with the plight of the financial institutions, we will change this situation which presently denies competition and free choice.

Simply put, where banks' choose, they can legally charge 15% for the same loan that GMAC is legally restricted to 10%. There is something wrong with allowing an inequity to exist which denies any credit to many consumers.

Senate Bill #463 will not open the consumer credit market to the total freedom needed, but it will temporarily stop the serious threat to survival of many Arkansas small businessmen and afford credit to those consumers who need it most.

Lastly, as a response to those who feel sensitive to injecting a congressional remedy to a state's internal problems, may I respectfully re-state that the conditions that have caused this problem have come from outside the border of Arkansas. Your previous involvement in past legislation was in favor of a particular segment of the Arkansas economy in preference to the rest of the consumer installment credit sector. What Congress has done for business needs should now be extended to the consumer.

I will be most happy to answer any questions you might have.

Senator LUGAR. Thank you very much, Mr. Chalmers. Senator Dodd, do you have questions of the witnesses?

Senator DODD. Thank you, Mr. Chairman. I appreciate the testimony of these witnesses. It has been very interesting and enlightening.

I wonder if I could just ask a couple of questions. Maybe all of you would like to respond, even though the question is addressed to specific testimony. But you are all in related industries, businesses. So you might have some comments on it.

Mr. Conners, in your testimony, on page 2 of it, you said that—quoting you: "Certainly, we understand the concerns that led to enactment of rate ceilings." And then you suggest—in fact, I think almost all of you suggest—the volatility of the interest rates really created the most serious problem for you in terms of these restrictions. I am wondering if there remains a legitimate concern about unconscionable interest rates, and it might not be worth our time to consider some flexible rate.

FLEXIBILITY WITH CEILINGS

Someone pointed out the 5-percent increase in interest rates in a 2-month period which raises, obviously, some problems in terms of response to that kind of situation. But if there was some legitimacy to setting ceilings in the past—granted the volatility of the interest rates adds a problem to restrictions—might we not consider some flexibility with ceilings, rather than just having them opened up entirely?

Since I addressed the question to Mr. Conners, I think you can start out.

Mr. CONNERS. Would you like for me to respond first?

Senator DODD. Anyone——

Mr. CONNERS. I think it has already been stated here this morning, Senator, that the conditions have changed somewhat since the time and the conditions that were in effect at the time these rate caps were enacted. At that time, I think the parallel was drawn that in the State of Arkansas the rates were at about the 2-percent level, when the 10-percent level was established.

The concerns at that time were that the customers would not be unduly socked with an unconscionable rate. The conditions, as was stated earlier, have changed somewhat since that time. It is our

holding that competitive pressures in each market are going to cause those rates to stay at an equitable level.

One thing I think we all have to remember is that lenders are also borrowers, and borrowers in these high-interest periods have to borrow at whatever the market is. They certainly then should be allowed to recover at a rate that is consistent with the rate at which they borrowed.

And the best way, we think, to do that is to allow the rate to be free enough to attract the independent finance sources back into the financing of retail automotive contracts. That's what has caused the hardship on the consumers. The independent retail finance sources have, and rightly so, made the determination that they could place their funds in more lucrative places with less risk than the rate caps that have been imposed on these several States.

Senator Dodd. Does anyone else want to comment?

Mr. [illegible]. Senator Dodd, I would like to comment. Philosophically, I am in agreement with the remarks made by Dr. Johnson with regard to the present situation. And with regard to our customers, I mentioned a very strong credit profile of the customer—90 percent of them being homeowners. I think we have an ideal kind of customer that could represent a very good financing product for the thrift institutions as this deregulation of the thrift institutions, the savings and loans, continues to occur. I think this kind of a customer would broaden the base of their financing, and possibly help their profitability situation in terms of the deregulation of both the savings interest rates that can be paid and the other changes. And I think the free market condition and the availability of financing will really take over and is quite different than the period, as Dr. Johnson indicated, back in the 1800's when the usury statutes were initially conceived. And I think many of the conditions that existed then are not in existence today.

Mr. [illegible]. Senator, there's no question that volatile rates have affected us. Just take one specific statistic. In the [illegible], the prime rate changed [illegible] times. In the [illegible] years from [illegible] to [illegible], the prime rate changed roughly [illegible] times. And in the 1 year, 1980, the prime rate changed around [illegible] times.

No business—wholesale, retail, or any business—can operate under that type of volatility, because you just cannot plan for the future. But the important thing in our retail business is that the volatility of the rates affects the wholesale floor planning costs. They go up and down [illegible] with the prime rate, and directly from a retail standpoint, the effect was more psychological, probably, with the consumer.

We found when the prime rate went up, our sales went down immediately. But [illegible] finance companies had not even changed the rate. My guess would be that the rates set by the finance companies and the banks during the year 1980 probably changed [illegible] times while prime rate changed [illegible].

But the consumer felt, when he heard of a prime-rate increase, he felt that something was happening, and he just withdrew temporarily from the market. So the volatility has affected us in that area.

We heard Congressman LaFalce relate the New York situation. To comment briefly on that, relating to the volatility, New York

had a usury rate in the mid-1950's, that was set at 12.68 percent. That rate was 4½ times the prime rate at the time it was set. That's a true usury control, and it was realistic. When New York finally changed, the prime rate or their usury rate was 60 percent of prime.

So obviously, it was not usury. But it was a consumer protection. Now, when we did this in New York, and had this changed, it took many years to have the change, because here again, the volatility affected it. Everyone was interested in New York State, but as the prime rate went down, two different times, all of the efforts ceased until they started up again, and everything became a problem.

In New York, we considered the time requirement, we considered the variable control that you're talking about by tying into something. They finally rejected all of the restrictions except time. And we have, I believe, a 3-year reconsideration.

It was felt, frankly, that politically the legislators in our State—and this would apply to all States—they would not be particularly astute if they were considered by their constituents as removing an obvious consumer protection or a perceived consumer protection. But they would not take that aggressive step.

But if they had a Federal override with a 3-year limitation, or something of that sort, the reconsideration would just slide by, and it would not take an aggressive act in that direction. So New York State rejected all the restrictions except the time one.

And it's proven to be, with the total removal of all other restrictions—the sky did not fall down, retail business resumed, everything else returned to normal, and some of the goblins we've talked about here have not ended our business in New York State.

So it took us a long time to do it, but when it was done, it was a responsible act—and actually a protection for the consumer, because a 10-percent usury, or 12 percent in New York State, was really no protection at all; it was a restriction on the customer's ability to buy.

Senator DODD. Do you have anything to add?

MAXIMUMS CAN BECOME MINIMUMS

Mr. CHALMERS. Senator Dodd, you can go back to the 1950 and 1960 period in the State of Arkansas, where the 10-percent usury was considered a maximum. And when you compare that period and what the rates were in installment credit, you come up to the area where we have wag[illegible] and price control. If you're not very careful, maximums becom[illegible] minimu[illegible] and that's what you have to watch. When you estab[illegible] or lending institution might charge on the top en[illegible] to gravitate to that for the minimum as well.

The best resolution to your concern—and I can appreciate your concern—is to make sure that the marketplace has enough competition to insure that the customer receives the best possible rate for any of his borrowing.

[illegible] Thank you.

[illegible] Senator Dodd, if you [illegible]

[illegible] I would like to make a request.

Mr. Miller, in your testimony, and I would jump to it here if I can, you cite some statistics with regard to the various States. I am looking at page 2, last full paragraph of your statement, where you talk about various States, or at least the collective States.

Here you quote from an article in a 1980 issue of Wall Street Journal: "A prime rate of 18½ percent makes personal auto loans 'unattractive' to banks, because of usury law limitations, in 36 States. Those States accounted for about 59 percent of all auto sales last year. While several States have since revised upward their usury limits, some 25 States still have interest rate ceilings on automobile credit of 18 percent or less."

You talk about a 30-percent turndown rate of all consumer retail finance contracts. I'd like to know what the turndown rate would be in the 25 States that now do not have limitations, which States those are in terms of your overall volume of sales.

California, obviously, is a huge volume sales State in automobiles. And it might help in terms of assessing the impact of usury laws on automobile sales if we had a fuller picture of what actually happens in turndowns. Maybe you have that, some of that information, now. If you do, I'd be glad to hear it.

Mr. MILLER. We'd be glad to furnish that to the committee. I don't have it here with me, but I can see where it would be important to your deliberations. We'll furnish you—even make a survey, if necessary, to give you some handle on that.

Senator DODD. Can I ask you how you got that 30-percent figure, and how much was directly related to usury laws? Are you directing all 30 percent of that to usury?

Mr. MILLER. No, I would not think so, but certainly a proportional amount of that turndown. The turndown rate floated from 30 percent in the surveys we made at that time, when we called several hundred dealers during a specific period. We did this two or three times, and continued to get that figure.

We have also gotten the 30-percent figure from about 1,500 dealers that we call 20 groups in our business, where they compare figures and that sort of thing, and submit information to NADA. It's all computerized. And they furnish us with the appropriate information.

The 30 percent is a common, consistent figure over the last few years, except for the peak interest rate periods. It jumped for short periods as high as 50, and a little higher.

Senator DODD. Last question, Mr. Chairman.

OBJECT OF A TRIPLE WHAMMY

To you, Mr. Gilbert, representing the recreation vehicle industry: In your testimony, you stated that your industry is the object of what you call a triple whammy.

Mr. GILBERT. Right.

Senator DODD. You cite national fear about interruption of oil supplies and the gas crunch, the increased price of motor fuel, and the squeeze between rising interest rates and State usury ceilings, and I wonder how you can separate out these items in terms of their responsibility for your industry's problems.

The first two factors that you cite hit before the surge in interest rates—for example, the prime rate averaged 12.66 percent in 1979

and it would seem to me might well be the major cause for the dropoff in Coachmen's business that you cite between 1978 and 1980, 1978 being a very good year. And then you had that tremendous drop, down to $125 million in sales in 1979. This year, for the first 6 months, you indicated $100 million in sales, an annual picture looking at about $200 million.

So given the fact that you've had this volatility, you understand my particular problem. It looks like you're in for not as good a year as 1978, but certainly a lot better than between 1978 and 1979.

Mr. GILBERT. We are working like heck to make it that way. We're trying.

Senator DODD. I understand. But in light of the problem we have in front of us, I just wonder how you might reconcile that increase in volume and business with the problem we're addressing here today.

Mr. GILBERT. I understand your question. It's very hard to put a percentage figure on the causes of the decline, and so forth.

We do know—we have national dealer councils that meet with us regularly in each of our divisions. We get a feeling from them. We get a feeling from surveys that we make of dealers, and we do make comparisons of the effects of sales in various States. For example, the State of Washington was a tremendous State for us at one time; has been very hard hit because of the restrictive laws there. Dealers complain very vigorously. So, we do have a feeling.

We are getting the feeling that—as I stated in my testimony, my comments—that some of the effects of the energy situation are abating in the minds of the potential customers. They found, you know—they think it's going to be better. As I mentioned, they find they can have a lot of pleasure in the parks of Connecticut, maybe, rather than going down south to the parks. So some of these situations are abating.

But we are faced—right now, the situation really is the squeeze, and we feel that. And that is having a continuing effect. These things are piled one upon the other, you know, one, two, three, on small businessmen. And their cash flow has been—was affected very seriously, obviously, in 1980—1979, then again in 1980 with the credit crunch, and now continuing the unavailability or nonavailability of the consumer credit. So they're just one, two, three, very difficult times.

Senator DODD. But without necessarily attributing a percentage——

Mr. GILBERT. I can't give you a percentage. I just know we have the feeling that the credit situation is our most concerning problem at this time.

Senator DODD. Thank you, Mr. Lugar.

Senator LUGAR. Thank you, Senator Dodd.

Mr. Miller, in the two tables that you have given of extensions of credit by type of lender, let me inquire for the sake of the record, what is the reason for the finance companies, in January of 1981, making 42 percent of all of the extensions, as opposed to banks doing somewhat less than 36 percent? Why would finance companies be able to extend credit in that amount, while banks are not?

Mr. MILLER. Well, a dealer basically has a major finance connection. With respect to banks, the ultimate turndown rate is 100

percent, and when a bank gets out of the finance business, the turndown rate becomes 100 percent.

I was going to mention in connection with Senator Dodd's question, as I thought about it after he asked it, about the variation in turndown rates between controlled and uncontrolled States, I would suggest that maybe as far as the captive finance companies are concerned, I would say the turndown rates would be very close, because in effect they are subsidizing, and in effect providing a service to the dealers, so the dealers can sell any cars in that State, because many of the—often, captive finance companies are proportionately losing more money as the usury rate gets lower in any given State. And this figure is alarming, and I think it's going to change even more so as banks continue to remove themselves from the automobile—from the retail credit market.

Senator LUGAR. Under the column finance companies—by the finance companies, how many or what part of that 42 percent are the so-called captive finance companies?

Mr. MILLER. Basically, the finance companies—I would guess are almost all captive. I'm sure there would be some miscellaneous small companies which I am not aware of.

Senator LUGAR. The point of this table is that 42 percent of all the auto financing now is being done by Ford, General Motor, Chrysler affiliates.

Mr. MILLER. That's right. I have not heard of a case when a dealer loses his bank, that the bank was his basic connection. I have not heard of a responsible dealer that has asked his captive finance company to take on his wholesale and retail financing that has been turned down, so frankly they have done an excellent job of absorbing the dealers that have come through them but have been absolutely turned down as the banks have removed themselves from this business.

Mr. CONNERS. Mr. Chairman, could I reinforce that response from Mr. Miller, please? I think by the mere term "captive finance company," it would tell us that we belong to the parent motor company and we feel that we have a responsibility to the dealers in those States where they have rate caps. And as I stated in my testimony, particularly in Arkansas, we feel a strong necessity to support the dealers and the vehicle sales in those markets.

FINANCING A CAR AT 10 PERCENT

Senator LUGAR. Could you describe a typical deal in Arkansas? For example, given the usury ceiling of 10 percent, how do you go about financing a car, a Ford car?

Mr. CONNERS. You don't go about it any differently in Arkansas than you do in any other State, except that you gulp rather hard when you buy one at 10-percent when you know that your overall costs are much greater than that.

Senator LUGAR. Who is absorbing the cost? Where does this reappear? I mean, money is worth much more than 10 percent. Out of whose pocket does that come?

Mr. CONNERS. Ultimately it is looked upon as a market support function at the manufacturers.

Senator LUGAR. The Ford Motor Co. then accepts a loss of the difference between 10 percent and whatever the rate of money actually is?

Mr. CONNERS. Not directly. We do, but then ultimately we have to be supported from time to time by the parent company.

Senator LUGAR. All right, then. The finance company then is supported by the parent company, so one or the other of them is absorbing that difference. So the profit of the finance company, or ultimately the Ford Motor Co., is diminished that much.

Mr. CONNERS. Yes, sir.

Mr. GILBERT. Mr. Chairman, we're not fortunate enough to have a captive company so we have to go to the marketplace. We have to be able, in order to assist our dealers, we have been able to develop national agreements with major financing sources to provide help, particularly in the inventory financing area. When you ask the question who pays for this, obviously it has to be included in the price of the product, because it's a cost. It's a subsidy, it's in the price of the product; and thus, ultimately, the consumer, including the cash purchaser, pays for it. So it is spread across all of the product, really. I think it applies to Ford, too.

SHIFTING COSTS TO OTHER STATES

Senator LUGAR. This leads to an intriguing possibility that other States of the Union are supporting purchases of Ford cars in Arkansas.

Mr. CONNERS. Not entirely. Other States in the Union not restricted by rate ceilings, the retail rates in the so-called free markets are established by different methods. But I guess basically the competitive pressures in each of our 180-rate areas are the most determining factor. I don't know if the rates in States without rate caps would change significantly if the rate in Arkansas were to seek its market level.

Senator LUGAR. The rate would not change. But given your analysis, the overhead charged by Ford, or whoever else it was—generally, if you have absorbed in Arkansas or elsewhere a loss, it's going to be passed on in some other place where the tide will bear, I presume. In other words, I think what we are looking at here is a shifting of the incidence of taxation of sorts, or at least of costs, in which blockages in the system in one situation lead to something jumping out somewhere else.

Mr. CONNERS. Certainly Ford Motor Co., as well as General Motors and Chrysler Corp., have overall costs, you know. Whether they come proportionately from each State, I don't know.

Senator LUGAR. The reason I raise this question is to point out that this is a national issue? If, in fact, automobiles were purchased only in two or three States of the Union, or if they were a peculiarly local factor, then there probably is some philosophical basis for saying it is totally a State problem. Only Arkansas people have automobiles, whereas Indiana people have recreational vehicles.

But since, in fact, there appear to be automobiles everywhere when there are blockages in the system provided by all sorts of State laws and situations, then this leads to a considerable inequity

throughout our national market. And that, of course, is one reason why we're looking at this.

And you support, in your testimony, a look-see, certainly, and we've gone farther than that, as a matter of fact, of suggesting remedies and urgency for change. But we would appreciate, for the sake of the record, additional data that you might have that will lead to an answer to Senator Dodd's question, because it is important for us to try to isolate the effects of the interest and the credit problem as opposed to other problems.

Each of you have been very forthright in pointing out economic cycles, fuel costs and all sorts of other things that enter into this. But to the extent we can isolate the credit problem and the loss of sales and the loss of gross national product in this great country of ours, the loss of revenue coming into the Federal Government because we are unable to solve these problems in the market, these would all be very useful pieces of information as we proceed.

I thank you for coming this morning and for your patience in waiting for this time of testimony.

The chair would like to call on the final panel, Mr. Robert B. Evans, senior vice president and general counsel, National Consumer Finance Association of Washington, D.C.; and Mr. B. Douglas Brandon, Jr., of the Brandon Furniture Co., Inc., Little Rock, Ark., on behalf of the National Home Furnishings Association.

STATEMENT OF ROBERT B. EVANS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL CONSUMER FINANCE ASSOCIATION, AND B. DOUGLAS BRANDON, JR., BRANDON FURNITURE CO., INC., ON BEHALF OF THE NATIONAL HOME FURNISHINGS ASSOCIATION, ACCOMPANIED BY PAULA TREAT OF THE NATIONAL HOME FURNISHINGS ASSOCIATION

Senator LUGAR. Would you introduce your associate?

Mr. BRANDON. I have with me Paula Treat with the National Home Furnishings Association.

Senator LUGAR. Mr. Evans, would you proceed with your testimony first of all?

Mr. EVANS. Thank you, Mr. Chairman. As the committee is aware, we testified—I am Robert B. Evans of NCFA, National Consumer Finance Association. We testified in May at great length on preemption and I have incorporated some of that testimony in today's testimony, but will omit it from my summary because I believe the committee is familiar with it. Nevertheless, we would point out that we vigorously support S. 1406 and we commend the sponsor and the committee for having these hearings.

RESTRUCTURING FINANCIAL INSTITUTIONS

We support Federal preemption deregulation of State consumer credit and usury ceiling which we view, like Dr. Johnson, as simply a price control imposed upon the use of money. The Federal preemption of consumer credit usury ceilings is a natural step in the progression of deregulation and restructuring of our Nation's financial institutions.

I would like to reiterate, as have others before us, that it follows that if the largest group of creditors in the country may now charge market rates for the use of their funds, other creditor

groups who borrow from them must be accorded the same privilege. It's just a fact of life and this largest group is, of course, individual savers, and they are the source of virtually all savings.

With regulation Q on its way to oblivion and with it administered savings rates, the individual saver will be able to command market rates for his funds, and naturally we, as financial institution intermediaries which employ these funds, must be free to do the same thing or forgo lending when market rates exceed any statutory saving.

I would like to deal briefly with one area of the preemption which occurred during 1980, because I think it is significant here. Last year the Congress preempted State usury ceilings on first mortgage loans, commercial loans and agricultural loans and those regulating the financing of manufactured housing, mobile homes. The results have been salutory.

Many of the State rate restrictions on manufactured housing have proved insufficient to provide consumers funding for the purchase of new homes. The flexibility of the Federal rate is demonstrated by the experience of one of the Nation's largest finance companies. In March of 1981, shortly after deregulation preemption, that company operated under Federal preemption in 26 States. Today it continues to do so only in 33 States, providing for funding for housing which\simply would not otherwise exist under today's high money cost. This is one area which has worked, has worked dramatically, and for people who were in the most need of funding for housing support or housing.

NCFA believes enactment of title II of S. 1406 will increase the availability of credit by preempting State usury ceilings on consumer credit while retaining, and this is most important, all forms of State consumer protection provisions.

CONSUMER PROTECTION UNDISTURBED

As important as what S. 1406 will do is what it does not do. The bill leaves undisturbed the full panoply of consumer protections at the State level and at the Federal level, I might add. Consumer finance companies in our case are licensed and regulated in every State in which they operate. The licensing often includes an investigation of the applicant's character, fitness and financial stability. Regulatory requirements include examination by State examiners for compliance with State and Federal truth in lending disclosures, compliance with refunding provisions and supervision of collection practices.

Likewise, compliance with all other State regulations will continue. Virtually every State has a commissioner of consumer credit charged with the regulation of consumer finance companies. Every State has required disclosures for each type of consumer credit—15 States have requirements which substantially parallel the pattern of the Truth-in-Lending Act—48 States prohibit deceptive advertising. Virtually all States have adopted some form of statutory repossession procedures by which personal property may be recovered if wrongfully taken. Credit insurance is reserved to State control. Every State has its own comprehensive act regulating the sale of credit-related insurance. The premiums for such insurance and providing payments for violations.

These protections—we believe this is very important—will remain undisturbed by S. 1406 and compliance will continue to be measured by the State commissioners of consumer credit, just as banks and savings and loan associations continue to be regulated. Even where their first mortgage rate ceilings have been deregulated, the consumer finance industry will surely remain regulated.

Let me deal briefly with S. 963. We would welcome such legislation because it would provide some relief from the unique restrictions imposed in Arkansas and the District of Columbia. However, that legislation simply would not do the job. It simply substitutes one administered and inadequate rate for another. For this reason, we believe that a totally deregulated rate is—approach is vastly preferable.

The experience of floating or escalating rates on the State level reflects that adjustment of an administered rate, even a floating one, lags behind the financial marketplace. States such as Oklahoma and South Carolina, which have enacted laws patterned upon the Uniform Consumer Credit Code with ceiling and rate escalators, are now considering total deregulation.

Many States have attempted to provide rate relief on a floating basis or by providing for temporary relief with sunset policies, thereby deferring painful legislative reevaluation of the issue to a later date. And in our testimony we list here 20 States which, although having granted rate relief, have done so on a temporary basis, all of which will expire sometime within the next 2, 3, or 4 years.

Now, finance companies, like all other financial institutions, require the funds of other to relend. Financial institutions are liable for repayment of these funds at a fixed future date or date, unlike equity. Hence, the term liabilities is used to describe them. Unlike other financial institutions, however, only a minor percentage of finance company liabilities are deposits. Virtually all funds are purchased; that is, borrowed on the marketplace from the public or other financial institutions.

Finance company liabilities in 1980, as set forth in the attached Federal Reserve Board data, show that we had about 40-plus percent in short-term debt. This is debt due in less than 1 year, and it is obviously at current money market rates. It is obvious that finance company cost of funds must reflect current money market fund conditions and must, of course, be marked up in order to make a profit.

We have shown also in the following tables a list—well, it's in my summary on page 7. Elsewhere, the estimated overall cost of borrowing in 1979, 1978 for members—I believe this is a unique disclosure for any type of financial institution because it is gained solely from reports filed by our members with the association. And you can see in 1979 and 1978 the cost of funds varying by size of company ranged all the way from a low in 1978 of about 8 percent to a high for the small companies in 1979 of about 18 percent. It's quite obvious that if those companies are paying 18 percent or more for their rate funds, you simply cannot turn around and render that anywhere close to that rate, at least have 3 or 4 points over that.

The pressure and volatility of the high money costs with the prime rate reaching 20 percent impacts all segments of the consumer finance industry's markets. Although finance company rates as high as 36 percent apply in very few States with very small cash loans, Federal Reserve Board data revealed finance companies charged an overall average rate of 21.1 percent on loans made in 1980. This has really been true for the last decade.

Now, an interesting phenomenon here that is occurring; traditionally consumer lenders, the consumer small-loan type, has served the marketplace frequented by the marginal or less trustworthy borrowers. These are typically unsecured loans. It is apparent to us on the data that the Federal Reserve Board has collected on and compared with internal data compiled by NCFA, that our members are leaving the small, unsecured loan marked. Last year in 1980 we estimate the decrease in outstanding in this area was $2.3 billion, while in the overall there is an increase in loans outstanding; and much of this had to be accounted for by second mortgages. In other words, if you don't have a home and you don't have valuable security today or a very good credit rating, your chances of getting consumer cash credit have been much diminished.

We have included, Mr. Chairman, data here with respect to limitations on rate ceilings for various States, depending on whether we are looking at cash loans, the financing of other goods, the financing of automobiles, or whatever. And you can see many of these rate ceilings are simply so low that financing could not take place.

We would finally report that even the States themselves have obviously been acting in this area, but they are having problems in doing so. I refer to recent hearings in Michigan as reported by the Detroit Free Press. The Banking Commissioner Martha Seger stated through the press that market forces are better regulated, they are more informed and respond faster than any legislature on the face of the Earth. Consumers are better served and protected by numerous lenders competing for their business than by a hoard of bureaucrats sitting in Lansing.

Commissioner Seger stated removing ceilings on consumer loans would be an important step in reviving Michigan's stagnant economy. I think it's important we take the attitude of Commissioner Seger and other such commissioners into account, because they do not feel they will be left in a vacuum wherever preemption comes from; that they have other State laws and other laws protecting consumers and ample weapons to take care of abuses in the market.

I would also point out from the attached editorial from the Cleveland Plain Dealer, that that paper fully endorsed rate relief in the case of lending institutions in Ohio, pointing out some 122 consumer finance offices in Ohio closed since the last rate increase in 1975. No rate increases have been accorded while operating costs have risen 56 percent at the same time.

STATES RIGHT VERSUS FEDERAL PREEMPTION

Finally, I would like to anticipate or answer, although it's not in my summary presentation, the problem relating to States' r[illegible]its

versus Federal preemption. Simply, that situation does not exist today where we have a pure State administered rate structure. Quite obviously, not only with preemption from last year, but because we have national banks free to charge rates under a most-favored-lender doctrine; they have been accorded the right by the Supreme Court, or recognized their right to export these rates across State lines, whereas retailers cannot.

Simply, we do not have such a pure society as we imagine it to be out there and many, many Federal institutions, including credit unions which may now charge 21 percent as a result of recent enactments and regulatory pronouncements. Quite obviously the Federal Government is very much in competition with the State governments in the regulation of rates. So we feel strongly, the best way to resolve the uneven and the imbalances is to go ahead and preempt rates altogether. We strongly support it.

Thank you very much.

[Complete statement follows:]

STATEMENT OF

ROBERT B. EVANS

SENIOR VICE PRESIDENT AND GENERAL COUNSEL

NATIONAL CONSUMER FINANCE ASSOCIATION

Mr. Chairman and Members of the Committee

My name is Robert B. Evans, Senior Vice President and General Counsel for the National Consumer Finance Association (NCFA). Organized in 1916, NCFA is the national trade association of companies engaged in the consumer credit business. NCFA represents over 700 companies operating more than 15,000 offices serving the public throughout the country. The membership of NCFA is highly diversified ranging from single small loan offices to substantial nationwide organizations engaged in unsecured direct lending, second mortgage lending and the financing of the sale of durable goods. In sum, the consumer finance industry accounts for approximately one-fourth of all consumer credit extended or approximately $75 billion of the $300 plus billion outstanding.

NCFA greatly appreciates this opportunity to appear to present its views on S. 1406, the "Credit Deregulation and Availability Act of 1981" and on S. 963.

NCFA supports federal preemption and deregulation of state consumer credit and usury ceilings. These limits, whether bearing the appellation "usury limits" or "rate ceilings" are simply price controls imposed upon the "use" of money. Federal preemption of consumer credit usury ceilings is a natural step in the orderly progression of the deregulation and restructuring of the nation's financial institutions. Indeed, it follows that - if the largest

group of creditors in the country may now charge market rates for the use of their funds - other creditor groups who borrow from them must be accorded the same privilege. This "largest group" consists of individual savers, the source of virtually all savings. With Regulation Q on its way to oblivion, and with it administered savings rates, the individual saver will be able to command market rates for his funds; naturally the financial institutions/intermediaries which employ these funds must be free to do the same or forego lending when market rates exceed any statutory ceiling.

Unlike depository institutions which may curb lending and continue to retain their customers through savings, checking or trust services, a consumer finance company's sole relationship to a customer is the extension of credit. Turning down a customer translates to losing that customer. Accordingly, preemption and therefore continuing ability to serve its customers is a vital issue for the consumer finance industry, particularly during times of volatile money costs.

The consumer finance industry is unique among the financial institutions advocating federal preemption. While there is remarkable unanimity among federally regulated financial institutions that preemption is desirable, the consumer finance industry which is universally licensed, regulated or operating pursuant to state law also supports federal intervention.

Finally, the consumer finance industry is subject to considerably greater restriction in the employment of its assets than are competing financial institutions. These state-imposed restrictions include: (1) limitations on the amount and duration of credit that may be extended; (2) limitations on the type of property which may secure an extension of credit, and (3) extraordinary penalties for violations of contrct terms. NCFA does not, however, seek federal preemption of these restrictions, merely the deregulation of the rate component. We believe that "deregulation" of the above state-imposed restrictions should (and will) come from the states as a by-product of rate deregulation.

Previous Preemption of Consumer Rates

The Congress, various administrative agencies and progressive state legislatures have already, to a large degree, recognized the social benefit of deregulating interest rates. Congress preempted state ceilings on second mortgage lending restricting the Federal Housing Administration's Title I home improvement loan program in the Housing and Community Development Amendments of 1979. Last year, in the Depository Institutions Deregulation and Monetary Control Act of 1980, it preempted state usury ceilings on first mortgage loans, commercial loans and agricultural loans, and for the financing of manufactured housing (mobile homes). It also provided parity of powers for state chartered federally insured financial institutions.

The preemption of state usury ceilings on manufactured housing provides an instructive example of the benefits of federal intervention. Many of the state rate restrictions on manufactured housing have proven insufficient to provide consumers funding for the purchase of new homes. The flexibility of the federal rate is demonstrated by the experience of one of the largest finance companies. In March of 1981, that company operated under federal preemption in twenty-six states. Today it does so in thirty-three states, providing funding for housing which would not otherwise exist under today's high money costs.

Administrative agencies have also recognized the desirability of preemption. Last year, in its report to Congress the Interagency Task Force on Thrift Institutions concluded that usury ceilings produced undesirable economic effects, and recommended that Congress override such restrictions for consumer lending. More recently, the Secretary of the Treasury testified before the Financial Institutions Oversight Hearings that "...usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit in the economy. Instead, these ceilings simply alter or hide the cost and result in credit being allocated by non-market criteria. We would favor their preemption for all loans in the manner prescribed in the Deregulation Act."

<u>NCFA Supports S. 1406</u>

NCFA supports S. 1406, the Credit Deregulation and Availability Act of 1981, and commends its sponsors for this important step in deregulating consumer credit.

NCFA believes that the enactment of Title II of S. 1406 will increase the availability of credit by preempting state usury ceilings on consumer credit, while retaining all forms of state consumer protection provisions.

As important as what S. 1406 will do, is what it does not do. This bill leaves undisturbed the full panoply of consumer protections. Consumer finance companies are licensed and regulated in every state in which they operate. The licensing often includes an investigation of the applicant's character, fitness, and financial stability. Regulatory requirements include examination by state examiners for compliance with state and federal truth-in-lending disclosures, compliance with the refunding provisions and a supervision of collection practices.

While compliance with the maximum state rates would be eliminated through the passage of this legislation, compliance with all other state regulations will continue. Virtually every state has a commissioner of consumer credit charged with the regulation of consumer finance companies. Every state has required disclosures for each type of consumer credit; fifteen states have requirements which substantially parallel the federal Truth-in-Lending Act. Forty-eight states prohibit deceptive advertising.

Virtually all states have adopted some form of statutory repossession procedures by which personal property may be recovered if wrongfully taken. Credit insurance is reserved to state control; every state has its own comprehensive act regulating the sale of credit related insurance, the premiums for such insurance, and providing penalties for violations.

These protections will remain undisturbed by S. 1406 and compliance will continue to be measured by the state commissioners of consumer credit. Just as banks and savings and loan associations continue to be regulated, even where their first mortgage rate ceilings have been deregulated, the consumer finance industry will remain highly regulated under S. 1406.

In conclusion, Section 532(a)(3) of S. 1406 defines a creditor to include only those persons who complied with state licensing requirements or, in order to begin making extensions of credit, who become subject to the applicable regulatory requirements and enforcement mechanisms provided by state law. S. 1406 only preempts state usury ceilings, it does not preempt state consumer protections.

Administered Rates Have Proven Inadequate

While NCFA welcomes S. 963 as legislation which would provide some relief from the unique restrictions imposed in Arkansas and the District of Columbia, that legislation simply substitutes one administered - and inadequate - rate for another. For this reason we believe that a totally deregulated rate approach is preferable.

The experience of floating or escalating rates on the state level reflects that adjustment of an administered rate, even a floating one, lags behind the financial marketplace. States such as Oklahoma and South Carolina, which have enacted laws patterned upon the Uniform Consumer Credit Code with ceiling and rate escalators, are now considering total deregulation. Many states have attempted to provide rate relief on either a floating basis or by providing for temporary relief with sunset clauses, thereby deferring painful legislative reevaluation of the issue to a later date.

In the following states consumer finance laws face such a prospect:

Alabama Consumer/Revolving Credit (June 1, 1983)
California Industrial Loan/Retail Credit (September 1, 1982)
Connecticut Auto Sales (March 1, 1983)
Hawaii Industrial Loan (July 1, 1985)
Illinois Auto Sales (December 31, 1981)
Iowa Industrial Loan/Retail Credit (July 1, 1983)
Kansas Bank Loans (July 1, 1982)
Maryland Auto Sales (July 1, 1982)
Michigan Bank Loans/Auto Sales (December 1, 1981)
Minnesota Industrial Loans/Auto Sales (July 31, 1983)
Mississippi Small Loan/Auto/Revolving Credit (June 30, 1982)
Montana Deregulation (July 1, 1982)
New Mexico Deregulation (July 1, 1983)
New York Deregulation (June 30, 1983)
North Carolina Small Loan (July 1, 1983)
Rhode Island Second Mortgage (April 1, 1982)
South Carolina First Mortgage (June 30, 1985)
South Dakota Auto/Retail Sales (July 1, 1983)
Utah Consumer Credit (July 1, 1982)
West Virginia Installment/Auto/Industrial/Second Mortgage/Revolving (July 1, 1982)

Restrictive Ceilings and Capitalization

Finance companies, like all other financial institutions, acquire the funds of others to re-lend. Financial

institutions are "liable" for repayment of these funds at a fixed future date or dates, hence the term "liabilities" is used to describe them. Unlike other financial institutions however, only a minor percentage of finance company liabilities are deposits; virtually all funds are "purchased" (i.e., borrowed) on the market from the public or other financial institutions. Finance company liabilities in 1980, as set forth in the following Federal Reserve Board table may be classified as follows:

40.5% short term debt (due in less than one year)
34.5% long term debt (due in one year or more)
10.5% mixed liabilities, e.g., deposits, thrift certificates, and dealer reserves
14.5% stockholder equity
100.0% Total liabilities and capital

FINANCE COMPANY LIABILITIES AND CAPITAL OUTSTANDING

Type of liability	Amount outstanding: Millions of dollars			Amount outstanding: Percentage change		Percentage of total liabilities & capital	
	June 1970	June 1975	June 1980	1970–75	1975–80	June 1975	June 1980
Bank loans	7,552	8,427	15,438	24.1	79.4	9.7	8.8
Short-term	6,585	7,698	7,885	20.1	-4.2	8.9	4.5
Long-term	969	728	7,573	-23.9	956.7	0.8	4.2
Commercial paper	22,073	25,995	52,328	17.4	101.4	29.2	29.9
Directly placed	19,247	23,686	43,232	23.2	82.5	26.7	24.7
Dealer placed	2,826	2,220	9,095	-21.5	322.1	2.5	5.2
Other short-term debt	975	2,025	16,417	108.7	477.5	2.2	9.4
Other long-term debt	15,351	29,243	52,098	87.2	82.3	32.7	30.2
All other liabilities	4,514	8,426	18,383	85.7	118.2	9.5	10.5
Capital and surplus	9,947	13,991	25,330	40.5	81.7	15.7	14.5
Total liabilities and capital	60,577	88,716	175,025	46.5	97.3	100.0	100.0
Memo:							
Short-term debt	29,429	36,625	73,840	22.6	93.4	41.3	40.5
Long-term debt	16,479	29,730	60,471	80.5	103.4	33.5	34.5
Total debt	46,250	66,350	131,311	43.9	97.9	74.8	75.2

(Source: FRB Survey of Finance Companies, 1980)

With 40-50% of their liabilities in money market (short term) borrowings or equivalent, it is apparent that finance

company cost of funds must reflect current money market conditions. If this cost cannot be recovered in turn from the finance company borrowers - because of restrictive state rate ceilings - then return on invested capital becomes unsatisfactory (less than would be provided in a market regulated environment) or, at the extreme, nonexistent. Credit is denied, and some creditors go out of business or divert capital to more productive endeavors.

The estimated cost of borrowing for finance companies reflects the pressure money costs exert on smaller independent finance companies. Many of those companies are dependent upon rediscounting companies at rates of 4% or more over the prime rate. The following chart indicates the extremes of money costs to finance companies for the years 1978 and 1979:

ESTIMATED OVERALL COST OF BORROWING IN 1979 AND 1978

(In percent)

	1979			1978		
	High	Low	Median	High	Low	Median
Companies with Consumer Credit Outstanding of:						
$1 billion and over...........	12.49%	8.70%	9.54%	9.17%	7.33%	7.97%
$500 million and less than $1 billion.......	11.25%	9.04%	9.31%	8 86%	7.73%	8.31%
$150 million and less than $500 million	12.33%	7.80%	10.33%	9.12%	6.90%	8.16%
$50 million and less than $150 million	15.60%	7.73%	10.40%	9.75%	6.96%	8.98%
$10 million and less than $50 million	13.64%	6.50%	11.30%	14.00%	6.00%	8.78%
$1 million and less than $10 million	18.12%	7.60%	11.53%	13.00%	6.51%	9.26%
Less than $1 million.......	15.00%	8.50%	12.06%	16.00%	6 75%	9.75%
Total.	18.12%	6.50%	10.64%	16.00%	6.00%	8.95%

(Source: N.C.F.A.)

Usury Ceilings and the Finance Industry Market

The pressure of volatile and high money costs, with a prime rate hovering at 19% impacts all segments of the consumer finance industry's markets. Although finance company rates as high as 36% APR apply in a few states for very small cash loans, Federal Reserve Board data reveal that finance companies charged an overall average rate of 21.1% on loans made in 1980.

FINANCE RATES, MATURITIES AND AVERAGE AMOUNT FINANCED

	1972	1975	1977	1978	1979	1980
Average Finance Rates*						
Personal loans	21.1%	21.0%	20.5%	20.5%	20.5%	21.1%
Automobiles						
New	11.9%	13.1%	13.1%	13.1%	13.5%	14.8%
Used	16.5%	17.6%	17.6%	17.6%	18.0%	19.1%
Mobile homes	12.4%	13.6%	13.6%	13.4%	13.6%	15.5%
Other consumer goods	19.3%	19.8%	19.2%	19.0%	19.1%	20.6%
Average Maturities*						
Personal loans in months .	32.3	36.3	42.9	45.8	50.5	63.8
Automobiles - percent						
New - Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% over 42 months	--	--	26.4	45.3	59.2	68 3
% 37 to 42 months . . .	0.9**	23.6**	21.2	16.9	11.0	7.4
% 31 to 36 months	84.3	65.3	40.4	27.3	21.1	16.9
% 30 months or less						
Used - Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% over 36 months	--	--	8.7	21.9	40.8	49.0
% 31 to 36 months	47.7**	54.2	57 3	43.5	43 5	36.4
% 25 to 30 months	33.3	31.1	23 6	19 7	8.5	6.3
% 24 months or less	18.9	14.7	10.4	14.9	7 2	8 3
Mobile homes	106.4	121 0	126.9	130.8	133 4	137 2
Other consumer goods . . .	21.7	21.1	23 6	25.8	25.4	24.5
Average Amount Financed*						
Personal loans........... . .	$ 996	$1,260	$1,521	$1,572	$ 1,688	$ 1,975
Automobiles						
New..	$3,104	$4,096	$4,990	$5,590	$ 6,035	$ 6,316
Used................ .. .	$1,671	$2,249	$2,720	$3,169	$ 3,555	$ 3,807
Mobile homes	$6,307	$7,686	$9,174	$9,999	$11,617	$12,807
Other Consumer Goods	$ 396	$ 464	$ 563	$ 605	$ 600	$ 624

(Source: FRB)

Additionally, the three major segments of the industry; small loans, secondary mortgage and sales finance are often hampered by restrictive ceilings.

The small loans acts provide the framework for lending to consumers who would otherwise be effectively denied access to the credit marketplace. When money costs rise these loans, whose interest rates reflect their labor intensive and higher risk unsecured nature, become unavailable. Although Federal Reserve Board statistics reflect that finance company outstandings of personal loans at year end 1980 stood at $31.6 billion, up from $30.6 billion in 1979, these statistics are not truly reflective of the shift from unsecured lending.

At the end of 1979, NCFA estimates indicate that 38% ($11.7 billion) of the $30.6 billion in cash loans as reported by the Board was in loans secured in while or in part by second mortgages. Data are not available for 1980, but it is probable that second mortgages may have increased to nearly 50% of the $31.6 billion outstanding as reported by the Board. On the basis of this projection, approximately $15 billion in second mortgages was outstanding and 16.6 billion in unsecured loans, implying that the former increased by $3.3 billion in 1980, while unsecured cash loans actually decreased by $2.3 billion.

This drop in unsecured lending, as assets are shifted to second mortgage lending, is attributable in part to restrictions on small loan rates in states such as:

Arkansas:	10% constitutional restriction
District of Columbia:	No statutory provisions
Michigan:	31% per year to $500, 13% to $3,000 or 18% on the entire balance

New Hampshire:	2% per month to $600, 1 1/2% per month to $1,500, 1/2% per month on larger loans
Nebraska:	24% per year to $1,000, 18% to $5,000, 16% to $7,000

In the area of second mortgage lending, it is ironic that while first mortgage lending is at market rates, second mortgages are limited. Ceilings on second mortgage rates are often below the current cost of funds and the prime lending rate, as the state ceilings below reflect:

Arkansas:	10% constitutional restriction
Colorado:	18% per year (industrial lending)
Connecticut:	18% per year (if licensed lender)
District of Columbia:	15% per year
Florida:	18% per year
Kansas:	18% per year (UCCC large loans)
Maryland:	16% per year plus 2% fee
Oklahoma:	18% per year (UCCC large loans)
Pennsylvania:	1.45% per month (17.64% APR)
Vermont:	18% per year

Usury rates restrict the availability of credit for motor vehicles and other consumer goods in states such as:

Alabama:	18% retail sales
Alaska:	$10-8 @ 1000 (min. $12-10 @ 8 mos.) (acq. $25 motor vehicles; $10 other goods)
Arkansas:	10% constitutional restriction
Connecticut:	18% motor vehicle and retail sales
Michigan:	$12-10 @ 500
Minnesota:	18% retail sales (if retailer under $25 million in annual sales)
Missouri:	18% retail sales
Washington:	18% retail sales
West Virginia:	18% administered rate

The restrictive effect of state usury ceilings has been recognized by regulators such as Michigan state banking commissioner Martha Seger who in a Detroit Free Press interview stated "market forces are beter regulators. They are more informed and respond faster than any legislature on the face of the earth...consumers are better

served and protected by numerous lenders competing for their business than by a horde of bureaucrats sitting in Lansing." Commissioner Seger has stated that removing ceilings on consumer loans would be an important step in reviving Michigan's stagnant economy.

The attached editorial from the Cleveland Plain Dealer reflects the results of restrictive ceilings, citing the closing of 122 consumer finance offices in Ohio since the last rate increase in 1975. Since that rate increase finance company operating costs have risen 56% forcing some companies to move operations to other states with more favorable regulations.

Summary

Continuing piece-meal erosion of rate ceilings through federal legislation, administrative interpretation, and judicial construction, especially as it tends to favor federally chartered institutions, has resulted in a virtual "de facto" deregulation for many advantageously situated institutions.

This, along with the entry of savings and loans into consumer credit and the growth of unsecured consumer lending by banks, largely through the medium of the credit card, has forced the consumer finance industry to assess its competitive position. As a growing and highly important segment of the consumer credit market, it will compete favorably with other financial institutions; this can best be done in a totally deregulated rate environment. We strongly support immediate across-the-board preemption of all usury ceilings.

83-025 O - 81 - 13

Exhibit I

20—A THE PLAIN DEALER, SATURDAY MARCH 7, 1981

THE PLAIN DEALER

THOMAS VAIL Publisher and Editor
ROY O. KOPP Business Manager
DAVID L. HOPCRAFT Executive Editor

140TH YEAR NO. 66 DAILY 395,452 SUNDAY 457,111

EDITORIALS

Inflation hits loans

The battle against inflation sometimes has to yield while victims of soaring costs catch up. So it is that small loan companies in Ohio have made a reasonable case for charging up to 3% more in interest. The Ohio House has given overwhelming approval to a bill that would permit the rate to go from 18% to 21% and we urge the Senate to follow suit.

The last rate increase was in 1975 and the finance company lobby argued persuasively that since then operating costs have risen 56%. Profits have declined and 122 Ohio offices have closed. Some companies moved operations to other states with more favorable regulations.

For many borrowers and for a variety of reasons, the finance company is the only avenue for small loans and while their rates are higher than those of banks and credit unions, they are controlled. For an average loan of $1,165, the annual interest rate will be 27.79% compared with 25.27% at present.

Senator LUGAR. Thank you, Mr. Evans.

The Chair will call on Mr. Brandon for his testimony.

Mr. BRANDON. Thank you. Mr. Chairman, distinguished members of the subcommittee, my name is Doug Brandon and I am president and owner of the Brandon Furniture Co. in Little Rock, Ark.

Our firm was founded by my father over 30 years ago and I succeeded him in managing our five stores.

I would like to digress a minute to tell you that I have had the experience of starting from a very small business and hopefully building one to some degree of success. The first year I was in business in 1956 after serving in the army our annual volume was $123,000 with four employees. So we have to some degree of success increased that to five stores. I remember that first year our total display area was about 5,000 feet. Today we have over 120,000 feet of display.

In addition to operating the furniture stores, I have also been a member of the Arkansas General Assembly for over 15 years. It is my great pleasure to have served with both Senators Pryor and Bumpers. Actually also served as Senator Bumpers budget chairman of our legislative body.

In light of this background, along with the fact that Arkansas has the lowest State usury ceiling in the United States I feel particulary qualified to comment on the provisions of S. 1406 and S. 963.

So I hope you will allow me to approach this wearing three hats. One as a member of NHFA and serving on the board; one as a lawmaker in the State of Arkansas that has been addressed so often today; and one as a retailer of a small striving operation.

I serve on NHFA's board of directors and NHFA's government affairs committee. NHFA is a national trade association with voluntary membership of over 13,000 independent home furnishings retail stores located in all 50 states and the District of Columbia.

Members of the association are primarily family owned, single store operations with typical sales of under $1 million per year.

NHFA appreciates the opportunity to testify before the Committee. During the testimony today NHFA hopes to accomplish three things. First, to give the committee an overview of the home furnishings industry and the problems furniture retailers must cope with as a result of unrealistically low State interest rate ceilings.

Second, the testimony will address both S. 1406 and S. 963 to explain why we strongly support interest rate deregulation instead of the proposed floating rate concept.

Last, and perhaps most important, the annual percentage rate myth will be addressed in relation to the cost impact deregulation will have on consumers.

Nearly all retail furniture stores extend some form of credit. In fact, the financed customer sale has been the lifeblood of the retail home furnishings store and the purchase method many consumers find essential. Whether they are buying basic household furnishings or acquiring furnishings to maintain their standard of living, customers expect to be able to finance these major investments just as they would an automobile or a home.

Historically the home furnishings dealer has been able to fulfill this expectation either by financing the sale himself or by assign-

ing the credit contract to an outside source such as a bank or a finance company.

CUSTOMER LOYALTY

Customer loyalty is the primary reason retailers carry their own accounts. Studies have shown that credit customers tend to shop where they have an account and that they buy more and better merchandise. The consumer gains a responsive, reliable supplier and the retailer achieves growth as he cultivates and markets to his own customers.

Of course, the retailer incurs many administrative costs in carrying his own accounts. These include forms, postage, stationery, equipment, additional personnel, losses on bad accounts, and interest paid on moneys borrowed to continue his business operation while repayment over a period of time is being made by the customer.

As an illustration of the true extent of these increases consider these facts prepared by the Virginia Retail Merchants Association. And I would like to point out these particular figures are based on the first 8 months of 1980. On some of these examples, you recognize these percentage increases have greatly increased.

Postage was 15 cents—and these comparisons are from 1967 to 1980. Postage up 300 percent based on 15-cent postage.

Minimum wage, based on $3.10, up 148 percent.

Social security has gone up 39 percent.

Wages subject to social security, up 292 percent.

Energy cost index, which is a high cost factor for furniture stores, up 460 percent.

Consumer price index, up 143 percent.

Average prime rate—and these are certainly out of date—173 percent based on 15.35 rate.

Maximum allowable rate in Virginia, which as 18 percent, has had an increase of zero. And certainly you all know in Arkansas we certainly had a zero rate increase based on 10 percent.

If the retailer cannot absorb these costs with the finance charges collected on credit sales, these costs must be deducted from any profits gained from the sale of goods.

Thousands of home furnishings retailers are facing financial extinction today. Retailers who carry their own accounts are crushed between the tremendously increased cost they must pay for credit services and the limit on finance charge rates they may legally collect.

Retailers who have used third parties for financing customer credit sales have found most banks and finance companies have abandoned retail credit for more lucrative markets. Of the few which are still involved many are charging retailers as much as 10 percent of the amount financed, and all have much more restrictive credit granting policies.

Fair competition, which is essential to keep consumer prices reasonable, is reduced as small businesses are forced to give up in-house credit and are denied equitable outside sources.

There is a resultant drop in sales and market share, which is picked up by larger businesses which have the financial resources

or compensating out-of-State outlets to temporarily withstand the impact of the credit crunch.

For the small retailer without in-house credit whose bank or finance company now refuses his contracts and the small retailer with in-house credit who can no longer afford a bank loan at rates considerably above prime to cover his accounts, the future is frightening indeed. Small businesses are closing their doors or facing bankruptcy as they watch sales fall simply because they cannot offer financing to their customers who need it.

RETAILERS MUST RAISE PRICES

To cope with unreasonable finance charge rate limits, retailers must raise prices, reduce services, or discontinue offering credit. Each of these choices has an adverse effect on the consumer.

When prices are raised to cover credit costs the cash customer is in effect subsidizing the credit customer. The cash customer is also penalized when a retailer is forced to discontinue services such as delivery or must charge an additional fee for them.

When credit is restricted it is the low-income consumer who is first affected and may be forced to become a cash customer. In effect, the low-income cash buyer is subsidizing the higher income credit user.

Most troubling, however, is that the low-income consumer is denied fair access to essential goods. Unable to purchase with a lump sum and unable to utilize store arranged credit, he may be forced to borrow from illegal sources at exhorbitant costs. Or he may be forced to do without the merchandise he needs to buy and the retailer needs to sell.

I'd like to digress there for a moment and say in Arkansas, even with our interest rates, we felt the illegal credit market, created problems and passed a bill in the late 1960's to outlaw debt pooling and those type of operations which the Congress later addressed on a national level. Even though we tried to address these on certain State levels it was later addressed on a national level. So we do have national legislation speaking to an area of this nature.

NHFA has reviewed both S. 963 and S. 1406 as requested by this committee. While NHFA fully endorses S. 1406, the Credit Deregulation and Availability Act of 1981, NHFA has reservations regarding S. 963, the general usury override.

Although S. 963 would offer immediate relief to my State, Arkansas, by allowing interest at a rate of 1 percent in excess of the discount rate on 90-day commercial paper, this bill would not alleviate the national problem closed-end and open-end rate creditors face.

One problem with a floating rate is that any point spread eventually established might not cover inflationary costs. A more serious problem is that the cost of implementing rate changes, especially for revolving accounts, could make a floating rate both impractical and costly. New forms, new billing notices, and in some cases new computer programs would have to be produced to conform with required rate changes. In addition, consumers who did wish to credit shop for a major purchase might be very discouraged to find their local store changing rates every 3 to 4 months.

NHFA commends Senators Bumpers and Pryor for their tremendous effort on S. 963. However, our association does not believe S. 963 will help small businesses in any substantial way.

S. 1406, on the other hand, seems to offer the best practical answer to ailing small business throughout the United States without removing any consumer protections or States' rights to reimpose ceilings.

The lifting of external limits would permit competitive rates, the basis for reasonable cost. Deregulation would put retail credit on a level with bank credit, business and agricutural loans across the country. The consumer would continue to be protected by Federal truth in lending as well as individual State consumer credit protection laws.

With deregulation consumers would also be protected by competitive rates. The combination of fair disclosure and competitive prices for credit would allow the consumer to shop, compare, and safely decide for himself or herself what he or she can afford to purchase on credit.

Under Federal truth in lending creditors are required to disclose the full cost of financing a loan or purchase. One of the requirements is that interest or finance charges be expressed in terms of APR.

Consumers are aware of annual percentage rates but generally do not know what they mean in dollars and cents. Many believe that an APR of 18 percent means an added $180 on a loan of $1,000 for 12 months. Since these loans are calculated on a system of declining balances and the customer makes monthly payments by agreements, the added cost is actually $100.16 and not $180.

This is easier to understand when one realizes that the APR would be the actual credit charge if no repayments were made for the entire year. However, since installment sales require repayment during the course of the year the effective credit charge is a substantially smaller percentage of the amount financed than the APR seems to indicate.

The true significance of raising or lowering the APR is easier to keep in perspective if one uses a similar process of converting it to dollars and cents.

A living room purchase of $1,000 at an APR of 14-percent would cost the customer $89.79 a month for 12 months. Raising the APR to 18 percent would cost the customer $91.68 per month for 12 months, less than $2 a month more than the 14 percent rate. Raising the APR to 22 percent would increase monthly payments on the same purchase to $93.59, again an increase of less than $2 a month.

In spite of the seemingly substantial increase in APR from 14 to 22 percent, the monthly increase in cost is less than $4 and the annual increase is approximately $45.

A similar calculation could be used to estimate the cost of two-tier systems used in many States in financing more expensive purchases. The allowable finance charge rate drops significantly for financed amounts over $1,000 in many States. Yet such amounts are common in the retail sale of home furnishings. In all cases the added revenue to the retailer barely offsets the cost of

carrying the credit account and the additional burden to the customer is not significantly greater.

Congress has long recognized that financial problems are national in scope and inevitably affect the relationship between business and the consumer on which the Nation's economic health depends.

Small businesses have been required to comply with complex Federal laws and regulations in the area of consumer credit for many years. At the present time Federal legislation regulates virtually every area affecting business/consumer relationships except credit ceilings. In addition, over the past 2 years Congress has supported the competitive market concept in both business credit and agricultural credit. Therefore, NHFA feels justified in requesting Congress to give small business equal footing.

We wish to emphasize that this request is not for a federally funded bailout, the lessening of consumer protections or an attempt to take away the prerogative of States to disagree. S. 1406 simply recognizes a national problem by placing all lenders of credit on the same footing.

Free enterprise built America. The furniture industry has grown thus far through free trade in a competitive marketplace. In the face of rising costs and the inability to charge realistic interest rates to those who use credit, we fear not only consumer credit will dry up, but many small businesses will not survive.

We would like to thank you, the members of this committee, for the opportunity to testify and we urge the prompt passage of S. 1406.

I would like to take a moment and maybe put my Arkansas hat on here. I know you heard a lot about it today. In the automobile industry we do have some degree of financing in Arkansas through the captive finance companies. But I would like to relate to what's really happened in a year's time in the State of Arkansas in our business.

BUSINESS SUFFER BECAUSE OF ECONOMY

We have lost 11 firms within a 70-mile radius of Little Rock, including Little Rock, with a population of a little over half a million people, or about one-fourth of our State population. These 11 firms had annual sales of $10 million and direct employment of over 300 people. These were taxpayers in each of our counties and our cities. These were not new companies. One company, John Tucker Co., 60 years in business; Arkansas Furniture & Carpet, 92 years in business. Everybody's in Russellville, Ark., 19 years in business; Curtis Finch, 34 years in business; Contemporary Designs is relatively new, it was only 5 years; Nixon Furniture in Hot Springs only sold out last week—16 years in business; Burton Francis, 35 years in business; Strong Furniture, 40 years in business; Foster Furniture, 45 years in business; and Moses, a company referred in the May issue of Wall Street Journal that's a part of your record, that firm has been in business over 55 years.

So these are not new companies that are suffering because of the economy. They are past the 7, the 9 years that it takes to get a company on a sound basis. But the economy, the restrictive interest rates in Arkansas have destroyed these businesses.

It used to be in our firm—and if you'll pardon me, I'll try to use some personal references—we used to sell some contracts to our bank at retail and we carry a lot of our paper and borrow the money from the bank to carry it. But at the same time on large purchases we used to sell it to the bank. We would sell them $250,000 a year. Starting a year ago last April that was eliminated completely. They did offer us financing of the purchase, after a 20-percent downpayment; was $3,000. And if we set up a 5-percent reserve and if we took our customer down to the bank so they could sign the contract in the bank.

Well, this was eliminated—and since that time I have sold only one contract to the bank. Because in furniture it's not like automobiles. There are a lot of $2, $3, $5, $800 and $1,200 items. And what good is it to provide financing so somebody can perhaps buy a home or make a decision by offering relief on a home if they cannot buy furniture to have in the home.

Fortunately, automobiles are sold with tires, because if they weren't they couldn't drive the car off because they couldn't finance tires in the State of Arkansas today.

Now, you know, we think we're part of this Union. We're part of these 50 States. And we think that's where the Congress is supposed to address problems that we have in Arkansas.

You may wonder why in the world are we living with this type of a constitutional restriction or how it ever got there. But it basically goes back to the Civil War and the constitutionalists in those particular days thought they were protecting the people from the carpetbaggers in the North. But you know, after a hundred and some years that war has been long over and we have problems that need to be addressed and we cannot address them in Arkansas. We've tried. We're getting closer. I sponsored the legislation that will be voted on a year from November. But I am here to tell you that a year from November there will not be many of us left. Seventy percent of the independents are out of business in the last year in my market. Now, I'm a middle layer. I'm there. But a year from November if I'm back up here I'm going to be here as a full-time employed legislator doing something else. Because it's going to be left to Sears and Penney's and Montgomery Wards and the large department stores that can buy their money on a national market.

Now we feel, and I feel, that an independent can compete with large corporations. I have successfully and I intend to in the future. But when we have a restrictive monetary situation, then those are issues that I cannot overcome as a merchant. And we need your attention as quickly as it possibly can happen.

I know you don't move as fast as we move in the Arkansas legislature. But at the same time I would sure hope that we could get up and try to address the problem.

[The complete statement follows:]

STATEMENT OF

B. DOUGLAS BRANDON, JR.

On Behalf Of

NATIONAL HOME FURNISHINGS ASSOCIATION

Mr. Chairman and distinguished Members of the Subcommittee, my name is Doug Brandon and I am President and owner of Brandon Furniture Company, Inc. of Little Rock, Arkansas. Our firm was founded by my father over 30 years ago and I succeeded him in managing our five stores. In addition to operating furniture stores, I have also been a Member of the Arkansas General Assembly for over fifteen years. In light of this background, along with the fact that Arkansas has the lowest state usury ceiling in the U.S., I feel particularly qualified to comment on the provisions of S. 1406 and S. 963.

I am appearing today on behalf of the National Home Furnishings Association (NHFA). I serve on NHFA's Board of Directors and the NHFA Government Affairs Committee. With me today is Paula Treat, NHFA Director of Government Affairs. NHFA is a national trade association with voluntary membership of over 13,000 independent home furnishings retail stores located in all fifty states and the District of Columbia. Members of the association are primarily family-owned, single store operations with typical sales of under $1 million per year. According to industry surveys the top 100 retail furniture companies in the United States account for approximately 19% of the $18 billion of home furnishings sold in this country. It is also interesting to note that these same companies operate only about 6% of the some 30,000 outlets of home furnishings which exist today.

NHFA appreciates having this opportunity to testify before this Committee. During the testimony today NHFA hopes to accomplish three things. First, to give the Committee an overview of the home furnishings industry and the problems furniture retailers must cope with as a result of unrealistically low state interest rate ceilings. Second, the testimony will address both S. 1406 and S. 963 to explain why NHFA strongly supports interest rate deregulation instead of the proposed floating rate concept. Last, and perhaps most important, the Annual Percentage Rate (APR) myth will be addressed in relation to the cost impact deregulation will have on consumers.

Overview Of Why Home Furnishings Retailers Desperately Need Relief

Nearly all retail furniture stores extend some form of credit. In fact, the financed customer sale has been the lifeblood of the retail home furnishings store and the purchase method many consumers find essential. Whether they are buying basic household furnishings or acquiring furnishings to maintain their standard of living, customers expect to be able to finance these major investments, just as they would an automobile or a home. Historically, the home furnishings retailer has been able to fulfill this expectation, either by financing the sale himself or by assigning the credit contract to an outside source such as a bank or finance company.

Customer loyality is the primary reason retailers carry their own accounts. Studies have shown that credit customers

tend to shop where they have an account, and that they buy more and better merchandise. The consumer gains a responsive, reliable supplier, and the retailer achieves growth as he cultivates and markets to his "own" customers.

Of course, the retailer incurs many administrative costs in carrying his own accounts. These include forms, postage, stationery, equipment, additional personnel, losses on bad accounts, and interest paid on monies borrowed to continue his business operation while repayment is being made by the customer.

As an illustration of the true extent of these increases consider these facts prepared by the Virginia Retail Merchants Association:

Factor	1967	1980*	% Increase
Postage	$ .05	$ .15	300%
Minimum Wage	$ 1.25	$ 3.10	148%
Social Security	4.40%	6.13%	39%
Wages Subject to Social Security	$6,600	$25,900	292%
Energy Cost Index	100	560.54	460.5%
Consumer Price Index	100	242.8	143%
Average Prime Rate	5.63%	15.35%	173%
Maximum Allowable Interest Rate-Virginia	18%	18%	Zero

* = Statistics for first 8 months of 1980. Energy cost index is based on cost of fuels, fuel products and power: U.S. Bureau of Labor Statistics Producer Price Index. The increases in the Consumer Price Index are based on annual averages of the U.S. Bureau of Labor Statistics. Since 1980 all of the categories except the maximum allowable interest rates have increased significantly (postage 18¢, minimum wage $3.35, average prime rate in excess of 18%, etc.).

If the retailer cannot absorb these costs with the finance charges collected on credit sales, these costs must be

deducted from any profits gained from the sale of goods.

Thousands of home furnishings retailers are facing financial extinction today. Retailers who carry their own accounts are crushed between the tremendously increased cost they must pay for credit services and the limit on finance charge rates they may legally collect. Retailers who have used third parties for financing customer credit sales have found that most banks and finance companies have abandoned retail credit for more lucrative markets. Of the few which are still involved many are charging the retailer as much as 10% of the amount financed, and all have much more restrictive credit-granting policies.

Fair competition, which is essential to keep consumer prices reasonable, is reduced as small businesses are forced to give up "in-house" credit, and are denied equitable outside sources. There is a resultant drop in sales and market share, which is picked up by larger businesses which have the financial resources, or compensating out-of-state outlets, to temporarily withstand the impact of the "credit crunch."

For the small retailer without in-house credit whose bank or finance company now refuses his contracts, and the small retailer with in-house credit who can no longer afford a bank loan at rates considerably above prime to cover his accounts, the future is frightening indeed. Small businesses are closing their doors or facing bankruptcy as they watch sales fall, simply because they cannot offer financing to their customers who need it.

Why don't home furnishings retailers follow the trend and accept bank credit cards? Many of them do, but this does not solve the problem. A home furnishings purchase can be a major investment, and any bank card has a credit limit which may not cover the entire purchase. Even if it does, most customers are reluctant to use their entire line of credit for one purchase. Also, bank credit cards do not offer the extended payment plans which customers may prefer for major purchases.

The most important drawback to bank credit cards is that many credit-worthy consumers, particularly families in low income brackets, cannot obtain them. Home furnishings retailers traditionally provide credit to a much wider range of consumers than do banks. The credit that the retailer can arrange or provide for these consumers is often their only resource for financing essential purchases.

To cope with unreasonable finance charge rate limits, retailers must raise prices, reduce services, or discontinue offering credit. Each of these choices has an adverse effect on the consumer.

When prices are raised to cover credit costs, the cash customer is, in effect, subsidizing the credit customer. The cash customer is also penalized when a retailer is forced to discontinue services, such as delivery, or must charge an additional fee for them.

When credit is restricted, it is the low-income consumer who is first affected, and may be forced to become a cash customer. In effect, the low-income cash buyer is subsidizing the higher-income credit user.

Most troubling, however, is that the low-income consumer is denied fair access to essential goods. Unable to purchase with a "lump sum", and unable to utilize store-arranged credit, he may be forced to borrow from illegal sources at exhorbitant costs. Or, he may be forced to "do without" the merchandise he needs to buy -- and the retailer needs to sell.

Review of S. 963 and S. 1406

NHFA has reviewed both S. 963 and S. 1406 as requested by this Committee. While NHFA fully endorses S. 1406, the Credit Deregulation and Availability Act of 1981, NHFA has reservations regarding S. 963, the General Usury Override.

Although S. 963 would offer immediate relief to Arkansas creditors by allowing interest at a rate of 1% in excess of the discount rate on 90 day commercial paper, this bill would not alleviate the national problem closed-end and open-end creditors face.

One problem with a floating rate is that any point spread eventually established might not cover inflationary costs. A more serious problem is that the cost of implementing rate

changes, especially for revolving accounts, could make a floating rate both impractical and costly. New forms, new billing notices, and in some cases, new computer programs would have to be produced to conform with required rate changes. In addition, consumers who did wish to credit shop for a major purchase might be very discouraged to find their local store changing rates every three to four months.

NHFA commends Senators Bumpers and Pryor for their tremendous effort on S. 963, however, our association does not believe S. 963 will help small businesses in any substantial way.

S. 1406, on the other hand, seems to offer the best practical answer to ailing small businesses throughout the U.S., without removing any consumer protections or states rights to reimpose ceilings.

The lifting of external limits would permit competitive rates, the basis for reasonable cost. Deregulation would put retail credit on a level with bank credit cards. The consumer would continue to be protected by Federal Truth in Lending, as well as individual state consumer credit protection laws. With deregulation, consumers would also be protected by competitive rates. The combination of fair disclosure and competitive prices for credit would allow the consumer to shop, compare, and safely decide for him or herself what he or she can afford to purchase on credit.

The APR Myth And What Deregulation Will Cost The Consumer

Under Federal Truth in Lending creditors are required to disclose the full cost of financing a loan or purchase. One of the requirements is that interest or finance charges be expressed in terms of an Annual Percentage Rate (APR).

Consumers are aware of annual percentage rates but generally do not know what they mean in dollars and cents. Many believe that an APR of 18% means an added $180 on a loan of $1,000 for 12 months. Since these loans are calculated on a system of declining balances and the customer makes monthly payments by agreements, the added cost is actually $100.16.

This is easier to understand when one realizes that the APR would be the actual credit charge if no repayments were made for one year. However, since installments sales require repayment during the course of the year, the effective credit charge is a significantly smaller percentage of the amount financed than the APR seems to indicate.

The true significance of raising or lowering the APR is easier to keep in perspective if one uses a similar process of converting it to dollars and cents.

A livingroom purchase of $1,000 at an APR of 14% would cost the customer $89.79 a month for 12 months. Raising the APR to 18% would cost the customer $91.68 per month for 12 months, less than $2.00 a month more than the 14% rate. Raising the APR to 22% would increase monthly payments on the same pur-

chase to $93.59, again an increase of less than $2.00 a month.

In spite of the seemingly substantial increase in APR from 14% to 22% the monthly increase in cost is less than $4.00 and the annual increase is approximately $45.00. A similar calculation could be used to estimate the cost of two tier systems used in many states in the financing of more expensive purchases. The allowable finance charge rate drops significantly for financed amounts over $1,000 in many states, and yet such amounts are common in the retail sale of home furnishings. In all cases the added revenue to the retailer barely offsets the cost of carrying the credit account and the additional burden to the customer is not significantly greater.

SUMMARY

Congress has long recognized that financial problems are national in scope and inevitably affect the relationship between business and the consumer on which the nation's economic health depends.

Small businesses have been required to comply with complex federal laws and regulations in the area of consumer credit for many years. At the present time, federal legislation regulates virtually every area affecting business/consumer relationships except credit ceilings. In addition, over the past two years Congress has supported the competitive market concept in both business credit and agricultural credit. Therefore, NHFA feels justified in requesting Congress to give small business equal footing.

NHFA wishes to emphasize that this request is not for a federally funded "bail-out", the lessening of consumer protections, or an attempt to take away the prerogative of states to disagree. S. 1406 simply recognizes a national problem by placing all lendors of credit on the same footing.

Free enterprise built America. The furniture industry has grown thus far through free trade in a competitive market place. In the face of rising costs and the inability to charge realistic interest rates to those who use credit, NHFA fears that not only consumer credit will dry-up, but that many small businesses will not survive.

NHFA thanks the Committee for this opportunity to testify and urges prompt passage of S. 1406.

Mr. BRANDON. It's serious, and I can assure you that consumers are denied credit in my State. They're denied credit. The only way I survived is to cut out from 2-year terms and 3-year terms to 1 year.

Where somebody could afford a $50 a month payment, they can't afford a $100 or $150 payment, and that is why they are denied the same opportunities that our citizens have in other States.

Thank you very much.

Senator LUGAR. Thank you very much, Mr. Brandon.

Your testimony has, I'm certain, answered questions that would have been directed to you regarding your personal experience as a legislator, as well as a retailer.

I have no further questions of either of you. I think your testimony on behalf of the legislation certainly is comprehensive and straightfoward.

We appreciate your coming this morning, offering your own personal experience as well as the representation of people that you have come to represent.

That concludes this session of the hearing. On July 15, the subcommittee will reconvene for another hearing on this legislation.

Thank you very much.

[Whereupon, at 1:45 p.m., the hearing was adjourned to reconvene on Wednesday, July 15, 1981.]

CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981

WEDNESDAY, JULY 15, 1981

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met at 9:35 a.m., in room 5302, Dirksen Senate Office Building, Senator John Tower (chairman of the subcommittee) presiding.

Present: Senators Tower, Garn, Lugar, Schmitt, Proxmire, Dodd, and Dixon.

Senator TOWER. The committee will come to order.

Today we conduct the second in a series of hearings on S. 1406, the Credit Deregulation and Availability Act of 1981, and S. 963, a bill to authorize loans at interest rates in excess of certain State usury ceilings.

We have several witnesses this morning to contribute to what I think are going to be important comments for the record. Before we hear from our first panel, I'd like to recognize Senator Dodd for opening comments.

STATEMENT OF SENATOR DODD

Senator DODD. Thank you very much, Mr. Chairman.

I appreciate your holding off the start of hearings for a few minutes until I was able to get here this morning. I was present at the last day of hearings on this matter but, unfortunately, was not here early enough to make an opening statement.

Mr. Chairman, frankly I'm a little puzzled over the need for these hearings and the proposed legislation. I'm as sympathetic as the next person to the need for legislation to solve a national problem—some might say after my record in the House that I'm a little too sympathetic when it comes to Federal legislation to solve problems—but I have yet to really see compelling evidence that there's a need for this legislation.

Unquestionably, many retail merchants are having a tough time in today's economy, but it seems to me the major culprit is high interest rates, not usury ceilings.

Last week, Mr. Chairman, we heard a lot of testimony about the problems of Arkansas, a State with a constitutional usury ceiling of 10 percent, but we received no data to suggest comparable problems in other States. In fact, it appears that all other States have acted to lift their usury ceilings in the last several years and particularly in the last year and a half. In fact, Illinois and New York have abolished their ceilings in the last few months.

Therefore, while the cost of money is clearly going up, it seems to me the States are responding promptly and fairly to this problem and if we leave them to their own devices they will take care of this without any unnecessary Federal intrusion.

I also wonder why we should be involved in a matter whose consequences are restricted to the residents of a State. If the people of Arkansas choose a usury ceiling of 10 percent and it reduces the availability of credit in the State, then the people of Arkansas pay the price. I think it would take the most tenuous theory imaginable to find an interstate connection. We may not agree with the people of Arkansas about having a constitutional ceiling, and I certainly wouldn't want to have that kind of ceiling in my own State of Connecticut, but I frankly question what business it is of mine to overturn the decision that the people made in the most democratic forum possible, a statewide referendum.

One of the advantages of leaving this matter to the States is that they can experiment with various alternatives, from different ceilings to no ceilings to indexed ceilings to different ceilings and consumer protections for different types of loans. Why take the risk of choosing one alternative when we really don't have the kind of data to demonstrate that the alternative will work well?

To lift all ceilings is to rely on competition to regulate the marketplace and while I certainly support economic deregulation, both of the major national studies that have touched on this issue in the last 20 years have raised serious questions about the adequacy of competition to protect many borrowers. Particularly, when you get into some of the areas of our cities many customers or consumers are not protected. Most recently, the Interagency Task Force on Thrift Institutions has suggested that a substantial raising of the usury ceiling might encourage the competition we want and at the same time reduce the occurrence of usurious lending practices.

If a case can be made that there is a national problem that warrants our attention, then perhaps we might focus on a solution that would meet both of these objectives, but, Mr. Chairman, after listening to the first day—and I'm going to stay through this day and listen to the testimony—I'm concerned whether or not we are really responding to a situation that could far better be left to others and, in fact, the record would seem to indicate, given the Texas, New York, and Illinois situation of the last few months, that the States are in fact responding to this problem on their own and don't really need the guidance and assistance of the Federal legislature.

I thank you for giving me an opportunity to express my views.

Senator Tower. Thank you, Senator Dodd. It does my old unreconstructed Confederate heart good to hear——

Senator Dodd. I thought you would be pleased.

Senator Tower [continuing]. To hear a Connecticut Yankee make such a plea for States rights.

Senator Dodd. Mr. Chairman, don't get carried away.

Senator Tower. Senator Lugar, do you have any opening statement?

STATEMENT OF SENATOR LUGAR

Senator LUGAR. Well, Mr. Chairman, I appreciate, too, the statement of the distinguished Senator from Connecticut but this is not the time and place to debate the whole issue. I suppose that will come during the hearing. Clearly there is some logic in leaving all of this to the States if in fact we had decided with regard to all of the deregulation of banks, savings and loans, credit unions, and what have you to leave each of those problems to the States, too; if in fact we were to leave to the States restrictions on the amount of interest that could be paid to depositors.

However, we decided at least as a nation that we would have a national policy with regard to the input of money and how much it would cost each of these institutions. Then, on the other side of the coin, we have retained limitations by States on how much those institutions could charge for the money they are lending and this has led to some imbalances, and one of the prime reasons for these hearings.

Without prejudging the issue, I suppose it's not fair or logical to argue States rights on one side of the coin and then to let sort of a laissez-faire national policy go somewhere else, but that I suppose will come forward in the hearings.

Senator TOWER. Our first panel this morning consists of Jim Boyle, Ellen Broadman, and Henry Schechter; if you would, please arrange yourselves at the table in any way that you would like. Mr. Boyle is the director of government relations, Consumer Federation of America. Ms. Broadman is counsel for government affairs, Consumers Union of the United States; and Mr. Schechter is director, AFL-CIO Office of Housing & Monetary Policy.

We are delighted to have this distinguished panel here this morning and what I would like to do is to ask each of you to make your presentation and then we will question you as a panel and give each of you an opportunity to comment on the questions asked. I should like to advise you that your prepared statements will be printed in full in the record and you may sumarize for purposes of presentation to the committee if you choose. I think, given our time constraints, if you could do that, it would be helpful to the committee. However, you may proceed in any way that you see fit.

First, we will hear from Mr. Boyle.

STATEMENT OF JIM BOYLE, DIRECTOR OF GOVERNMENTAL RELATIONS, CONSUMER FEDERATION OF AMERICA

BILLIONS IN ADDITIONAL FINANCE CHARGES

Mr. BOYLE. Mr. Chairman and members of the subcommittee, Consumer Federation of America appreciates this opportunity to testify. Our comments will focus on S. 1406. This bill comes before the committee today purportedly as a continuation of the 1980 Monetary Control Act. We believe, however, that no other part of the 1980 act disrupted a delicate State balancing of lender profitability and consumer protection as S. 1406 promises to do. This legislation will eliminate State usury ceilings designed to protect the highest risk and most vulnerable group of borrowers. It will cost borrowers billions in additional finance charges, precipitate

thousands of new bankruptcies, and allow lenders to impose a variety of extra fees that will make comparison shopping for loans difficult, if not impossible. And while we recognize that the sponsors of S. 1406 are motivated by the good faith desire to expand credit availability and improve the financial position of lenders, we believe that empirical evidence suggests that neither of these goals is likely to flow from passage of this bill. If that is the case, what we will be left with are the legislation's massive costs, both to individuals and to an already damaged economy.

Before the committee acts to eliminate all usury protection, it should consider the experience of States which recently have eliminated interest rate ceilings or raised them to very high levels. In Texas, small loan companies are lending at rates over 200 percent on certain small loans. In Arizona, used car loans in excess of 50 percent and second mortgage refinancing at 100 percent are beginning to appear. And in Oklahoma, creditors now receive over 170 percent for a certain category of loans. S. 1406 gives lenders nationwide carte blanche to follow the lead of these and other States.

The increase in interest rates under preemption has other obvious economy-wide impacts as well. With over $313 billion in outstanding consumer installment credit, every 1 percent rise in the average APR will add over $3 billion to borrowers' payments. Given the wide range of rate ceilings among the States, an average APR increase of 5 percent or 10 percent may well follow closely on the heels of S. 1406. Such increases would produce economic shocks of $15 and $30 billion, respectively. In the end, S. 1406 could work at cross purposes with President Reagan's economic program by canceling out much of the effect of tax and spending cuts. Moreover, a multibillion dolar increase in finance payments could significantly affect the general rate of inflation.

INCREASED BANKRUPTCIES

In addition to higher finance charges, borrowers are sure to pay for S. 1406 in another way—increased bankruptcies. States with interest ceilings which are higher than the national average have about 20 percent more bankruptcies per capita than States with below average interest rates. A map which is attached to this testimony provides the comparisons between States.

I would like to shift to the main lender argument for usury preemption—that raising interest rates makes more credit available. This argument is false. On a State-by-State basis, credit is no more likely to be available in high interest rate States than it is in low interest rate States. Table IV, attached to this testimony, compares 1979 APR ceilings for 1-year $2,500 loans. The amount of loans made by finance companies on a per capita basis varied widely between States, with no apparent relationship to the level of allowable interest. This result is confirmed by a 1981 Arkansas study which showed that two of the three lowest income classes in Arkansas held more debt on the average than consumers with equivalent incomes in States with much higher interest rate ceilings. The study concludes that:

> Overall the data * * * do not support the hypotheses that credit is less readily available in Arkansas than in other credit markets—and they are particularly

inconsistent with the hypothesis that low income borrowers receive less credit in Arkansas.

Accordingly, even in the worst case State of Arkansas, empirical data demonstrates that credit is available in rough proportion to its availability elsewhere. It is therefore difficult to make the argument that S. 1406—by deregulating interest rate ceilings—will have any necessary impact on the amount of consumer credit.

It is important not to think of S. 1406 as solely an interest rate preemption bill—it is much, much more. This legislation will be the best friend the unscrupulous used car dealer or home improvement company would ever hope for. The bill renders null and void any legislation which limits the "rate, nature, type of, amount of, or the manner calculating or providing or contracting" for any fee or charge which a creditor may dream up to impose on a consumer.

The following effects can be expected from this legislation:

First: State laws limiting certain charges to what is "necessary and reasonable" would be preempted—unreasonable and unnecessary charges would be authorized.

Second: State laws limiting certain charges to out-of-pocket costs would be eliminated.

Third: Phony fees, which are really "interest," would be authorized to be charged and would not be disclosed as interest.

An example of the result of this legislation can be seen in Arizona which preempted fees and charges as well as interest rates. Advertisements placed in Phoenix newspapers begged consumers to come in and borrow on equity on their homestead. The ads show a copy of the check made in the amount of $5,000 just waiting to be filled in with the consumer's name on it. The potential borrower is told, "No co-signers, no checking with employers, no financial statements—Your home or property is the only reference you need." The loan scam is directed at low income borrowers. The loan repayment begins with very low monthly payments like $50 a month and then after 2 years a balloon payment is called for which is several thousand dollars. The borrower either pays the balloon or loses his or her home. If the loan is refinanced, the rates in Arizona, by use of a series of fees and charges, are running as high as 100 percent interest. Many States prohibit the refinancing of balloon payments at any greater rate or at any higher monthly payments than were in effect prior to the balloon payment. These restrictions would be rendered null and void by S. 1406.

TAKING THE TRUTH OUT OF TRUTH IN LENDING

In Texas, a used car dealer may charge up to $25 for a documentary fee and the dealer may charge the actual cost of license, tax, and title fees. If S. 1406 is passed, all these fees will be increased substantially over the dealer's actual cost. Any limits on what can be charged for these fees would be nullified by S. 1406. To the extent these fees do not reflect actual costs, they contain hidden interest, thus understating the annual percentage rate (APR). If the APR is phony, then comparison credit shopping is made impossible, since comparing APR's is at the heart of truth-in-lending.

It is our opinion that the effect of S. 1406 as far as many kinds of credit transactions are concerned, is to take the truth out of truth-in-lending.

Despite its good intentions, S. 1406 is costly and deceptive legislation. If passed, it may well usher in a new era of loan sharking, giving unintended license to predatory practices and extremely high finance charges. The bill will make credit shopping more difficult and is unlikely to expand the supply of credit in any significant way. S. 1406's high costs and interference with traditional State prerogatives make a strong case for its rejection by this committee.

[Prepared statement follows:]

THE IMPACT OF STATE INTEREST RATE AND FEE PREEMPTION

by

Jim Boyle, Director of
Governmental Relations
Consumer Federation of America

Mr. Chairman and members of the Subcommittee, Consumer Federation of America appreciates this opportunity to testify on S. 1406. This bill comes before the Committee today purportedly as a continuation of the 1980 Monetary Decontrol Act. We believe, however, that no other part of the 1980 Act disrupted a delicate state balancing of lender profitability and consumer protection as S. 1406 promises to do. This legislation will eliminate state usury ceilings designed to protect the highest risk and most vulnerable group of borrowers. It will cost borrowers billions in additional finance charges, precipitate thousands of new bankruptcies and allow lenders to impose a variety of extra fees that will make comparison shopping for loans difficult, if not impossible. And while we recognize that the sponsors of S. 1406 are motivated by the good faith desire to expand credit availability and improve the financial position of lenders, we believe that empirical evidence suggests that neither of these goals is likely to flow from passage of this bill. If that is the case, what we will be left with are the legislation's massive costs, both to individuals and to an already damaged economy.

DEGREE OF COMPETITION IN CONSUMER LOAN MARKET

The implicit assumption behind this effort to deregulate the consumer credit market is the existence of a competitive marketplace. Unfortunately, this assumption appears to be unwarranted. Less than a year ago, in testimony before the House Small Business Subcommittee, Lewis Odom, Senior Deputy Comptroller of the Currency, stated:

Consumer Federation of America gratefully acknowledges the assistance of Elizabeth Allaben and Michael Bernard in the preparation of this testimony.

> We must be mindful of the legitimate concern for the small, financially weak borrower who may fall prey to disreputable lending practices. In those parts of the country where credit markets are not yet reasonably competitive, there is a pressing need for minimum safeguards to protect the rights of the most vulnerable.
>
> <u>State Usury Ceilings And Their Impact On Small Business</u>, Committee on Small Business, August 26 and September 23, 1980, p. 118.

The Federal Reserve Board's most recent study of this area--the <u>1977 Consumer Credit Survey</u>--supports Mr. Odom's analysis. The FRB survey revealed aspects of loan demand which work to lessen competition, noting that only 30% of potential borrowers shop for loans and that most choose lenders based primarily on proximity and familiarity. Finally, the largest study of this market, undertaken by the National Commission on Consumer Finance, recognized structural features of the consumer lending industry which weakened competition. NCCF therefore found it necessary to couple its rate ceiling recommendations with extensive consumer protection proposals. In stark contrast, S. 1406 contains no consumer safeguards. Accordingly, the legislation would allow total interest rate preemption even in those states which traditionally have chosen to protect borrowers through low rates instead of through consumer protection statutes.

ECONOMIC IMPACT OF INTEREST RATE PREEMPTION

Before the Committee acts to eliminate all usury protection, it should consider the experience of states which recently have eliminated interest rate ceilings or raised them to very high levels. In Texas,

small loan companies are lending at rates of over 200% on certain small loans. In Arizona, used car loans in excess of 50% and second mortgage refinancing at 100% are beginning to appear. And in Oklahoma, creditors now receive over 170% for a certain category of loans. S. 1406 gives lenders nationwide carte blanche to follow the lead of these and other states.

Ultimately, this new lender freedom may underwrite a resurgence of loan-sharking across the country. Whether it does or not, the dollar costs of even small or moderate increases in the average rate on loans will be substantial. Tables I, II, and III demonstrate the diversity in allowable annual percentage rates (APRs) for consumer installment loans, auto loans, and revolving credit. If, under preemption, the present mean APR of 20.24% rose to the level of the highest APR of 33.18%, a borrower would pay additional finance charges of more than $300 on a one-year, $2500 loan. And if the lowest rate of 10% were to rise to the present highest level, the same borrower would be forced to cover over $580 in extra finance charges. Both of these calculations assume that post-preemption rates will go no higher than the current highest ceiling; the above examples from Texas, Arizona and Oklahoma suggest otherwise.

IMPACT ON PERSONAL BANKRUPTCY

In addition to higher finance charges, borrowers are sure to pay for S. 1406 in another way: increased bankruptcies. As average interest rates rise, available data shows that personal bankruptcy rates follow.

Chart I reveals that the states with interest rates above the national mean had a bankruptcy rate of 99 per 100,000 population. In contrast, states with below the mean interest rates had a bankruptcy rate of 83 per 100,000 population, a difference of 19.3%.

In reality, the relationship between high interest rates and bankruptcy is even stronger than Chart I demonstrates. Federal bankruptcy law permits different personal exemptions depending on state law. Additionally, varying state law concerning wage garnishment exerts a differential impact on the number of bankruptcies by state. These factors combine to produce bankruptcy data in four states that differ markedly from the other 46 states. (Two of these four states have APR ceilings above the national mean, the other two have ceilings below that mean.)

The following table demonstrates the relationship between interest rates and bankruptcy excluding the data from the four extreme states:

PERSONAL BANKRUPTCY IN HIGH AND LOW INTEREST RATE STATES

National Averages: Interest Rate on Consumer Loan, 1979=20.24%, $2500 loan, one-year
Personal Bankruptcy Rate, 1979 =89 per 100,000 population

	APR	Personal Bankruptcy Rate
High APR States	23.45%	99 per 100,000 population
Low APR States	16.34	83
High APR States (S.Car., Del., excluded)	23.57	102.5
Low APR States (Ala., Cal., excluded)	16.35	70.8

Accordingly, the data from 46 states reveal a substantial difference between bankruptcy rates in high and low interest rate states: 102.5 per 100,000 v. 70.8 per 100,000 population, a difference of 44.8%. It therefore seems quite likely that the rate deregulation intended by S. 1406 will inevitably lead to a rise in personal bankruptcies.

MACROECONOMIC IMPACT

The increase in interest rates under preemption has other obvious economy-wide impacts as well. With over $313 billion in outstanding consumer installment credit, every 1% rise in the average APR will add over $3 billion to borrowers' payments. Given the wide range of rate ceilings among the states, an average APR increase of 5% or 10% may well follow closely on the heels of S. 1406. Such increases would produce economic shocks of $15 and $30 billion respectively. In the end, S. 1406 could work at cross purposes with President Reagan's economic program by cancelling out much of the effect of tax and spending cuts. Moreover, a multi-billion dollar increase in finance payments could significantly affect the general rate of inflation.

IMPACT OF FEE PREEMPTION

Possibly the most deceptive aspect of S. 1406 is the near total preemption of state limitations on the fees and charges lenders can impose. State requirements that certain fees be either "reasonable and necessary" or be limited to lenders' out-of-pocket costs would vanish--e.g., regulation of credit report fees, tax, title and license fees and attorneys' fees. Without such limitations, lenders will be

able to charge fees in excess of their costs and thereby raise the true rate of interest to a level in excess of the disclosed APR. Thus, the goal of truth-in-lending--a single, easily understood disclosure that reflects overall borrowing costs and that can be compared across potential lenders--will be nearly impossible to meet.

Brief analyses of S. 1406 by the South Carolina Department of Consumer Affairs and the Maine Bureau of Consumer Protection reveal the potential reach of fee preemption. In South Carolina, the following illegal or limited charges could be imposed freely under the legislation before the Committee today: penalty charges, unearned finance charges, closing costs, deferral charges, duplicate charges for insurance, and charges on consolidations and refinancings. In Maine, the State Bureau of Consumer Protection believes that S. 1405 would preempt: the method and manner of calculating interest rates, the 25-day grace period, the prohibition on charging interest on current month's purchases, and the requirement that APRs be stated in their actuarial rather than their "add-on" form (the latter can understate actual finance payments by a factor of two or more). Additionally, the Maine officials believe that the plain language of S. 1406 will throw doubt onto state regulation of balloon payments, certain disallowed security interests, late fees and deferral charges.

We believe that the costs of fee and rate preemption are much too high to justify the enactment of S. 1406. In fact, we have serious questions as to whether any compensating benefits will actually come about.

IMPACT ON CREDIT AVAILABILITY

Supporters of S. 1406 claim that preemption of usury ceilings is necessary to guarantee an adequate supply of credit. The bill is even entitled the Credit Deregulation and Availability Act of 1981 (emphasis added). We remain unpersuaded, however.

By almost any measure, credit exists in abundance. In April 1981, consumer installment credit outstanding rose to $313 billion, equivalent to an annual growth rate of 9%. In addition to this outstanding credit, credit card holders have billions of dollars in unused lines of credit. And in response to unwanted credit, an estimated 9% of card holders cut up and returned credit cards to issuers in 1980.

Preemption is not only unnecessary, as shown above, but it also cannot be expected to increase the supply of credit. On a state by state basis, credit is no more likely to be available in high interest rate states than it is in low interest rate states. See Table IV. When compared with the 1979 APR ceilings for a one-year, $2500 loan, the amount of loans made by finance companies per capita varied widely state by state, with no apparent relationship to the level of allowable interest:

STATE	APR	PER CAPITA LOANS MADE
Washington	24.69%	$ 64.60
Pennsylvania	19.99	126.30
Nebraska	18.82	69.80
California	18.00	74.00
North Carolina	15.00	100.73

Sources: Cost of Personal Borrowing in the United States, 1979 Edition, and National Consumer Finance Association Report, The Consumer Finance Industry by State and Statute, 1978 (released January 1981). Data for approximately 25 other states can be found in Table IV at the end of this testimony.

A study included in the report of the National Commission on Consumer Finance acknowledged this lack of clear-cut evidence that rate ceilings are significantly related to credit availability.[1] This finding is confirmed by evidence from a 1981 study at the Credit Research Center of Purdue University. The Purdue study, by Richard L. Peterson and Gregory A. Falls, examined the empirical evidence regarding the impact of Arkansas' ten percent rate ceiling.[2] Its conclusions bear importantly on S. 1406. Consumers in Arkansas actually held as much consumer debt in 1979 as consumers in Louisiana (31.08% APR ceiling), Illinois (16.73% APR ceiling) and Wisconsin (16.82% APR ceiling).

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1. Robert P. Shay, The Impact of State Legal Rate Ceilings Upon the Availability and Price of Consumer Installment Credit, National Commission on Consumer Finance, Volume IV, 1974.

2. "Impact of a Ten Percent Usury Ceiling: Empirical Evidence," Working Paper Number 40, Credit Research Center, Purdue University, 1981.

Of even more interest, two of the three lowest income classes in Arkansas held more debt on average than did the consumers with equivalent incomes in Louisiana, Wisconsin and Illinois. The study concludes that:

> Overall, the data...do not support the hypothesis that credit is less readily available in Arkansas than in other credit markets--and they are particularly inconsistent with the hypothesis that low income borrowers receive less credit in Arkansas.
> (p. 22)

Accordingly, even in the worst case state of Arkansas, empirical data demonstrates that credit is available in rough proportion to its availability elsewhere. It is therefore difficult to make the argument that S. 1406--by deregulating interest rate ceilings--will have any necessary impact on the amount of consumer credit.

IMPACT ON PROFITABILITY

Similarly, high interest rate ceilings do not ensure high profitability. See Table V. A sampling of the data from Table V shows the lack of correlation between the APR ceilings on a one-year $2500 loan and per capita finance company profitability:

STATE	[illegible]	PROFITABILITY PER CAPITA
Washington	24.69%	$1.19
Pennsylvania	19.99	1.16
Nebraska	18 88	0.34
California	18.00	4.33
North Carolina	15.00	2.25

Sources: Same as for Table IV, see p. 8.

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A further example will help illustrate the total lack of correlation between APR ceilings and finance company profitability. The lowest per capita profitability for finance companies is in Florida, which allows an APR of 22.80%. In contrast, two of the three most profitable lending states--Minnesota and California--have lower APR ceilings, 18.73% and 18.30% respectively, both well below the national mean of 20.33%.

Based on these measures of availability and profitability, preemption would not appear to provide the answer for the ills of the lending industry.

STATES RIGHTS

S. 1406 is entitled "The Credit Deregulation and Availability Act." We suggest that this title misrepresents the actual aim of the bill. The Committee is not considering a bill to "deregulate" anything, as that term has come to be understood, but rather one commanding the states not to regulate. As a matter of analogy, it is one thing to "deregulate" the interstate oil industry, but it is quite another to tell oil producing states that they may not likewise regulate the intrastate oil industry. Deregulation implies the removal of federal controls, not the federally required removal of state controls.

Proponents of this legislation would like us to believe that because the bill permits states to reject preemption, states ultimately have final authority over it. This, Mr. Chairman, creates a false sense of reality regarding previous state action. All of the states have reconsidered their interest rate ceilings in the very recent past,

with forty four of them providing lenders with some kind of rate relief. By implication, then, the vast majority of the states have considered totally eliminating interest rate ceilings and, time after time, have rejected the idea. Accordingly, this bill not only forces the states to reject again that which they have already rejected, but since many legislatures will not meet for two or more years, S. 1406 requires consumers, farmers and small businessmen to agree to loan terms which their local elected officials have found to be antithetical to state policy. Obviously, if this legislation truly spoke for the rights and prerogatives of states it would require explicit state acceptance of preemption. It may well be a measure of the legislation's expected palatability that the sponsors chose this alternative route.

CONCLUSION

Despite its good intentions, S. 1406 is costly and deceptive legislation If passed, it may well usher in a new era of loan sharking, giving unintended license to predatory practices and extremely high finance charges. The bill will make credit shopping more difficult and is unlikely to expand the supply of credit in any significant way. S. 1406's high costs and interference with traditional state prerogatives make a strong case for its rejection by this Committee.

Table [illegible]

COMPARISON OF CONSUMER LOAN ANNUAL PERCENTAGE RATES

Based on $250 Loan To Be Repaid in
Twelve Equal Monthly Installments

1975		1979	
State	APR	State	APR
Mississippi	33.15	Mississippi	33.15
Louisiana	31.28	Louisiana	31.26
Georgia	26.15	Georgia	27.79
Washington	24.75	Utah	25.67
Hawaii	24.28	Idaho	25.67
Rhode Island	24.30	Washington	24.69
Tennessee	24.30	Indiana	24.36
Utah	23.35	Hawaii	24.28
Idaho	23.35	Tennessee	24.30
Indiana	22.27	Rhode Island	23.95
Delaware	22.08	Alaska	23.54
New Jersey	21.89	Florida	22.85
Wyoming	21.75	Kansas	22.66
Oregon	21.75	Maine	22.17
Colorado	21.75	Delaware	22.08
Arizona	21.68	New Jersey	21.89
Montana	21.63	South Dakota	21.77
Iowa	20.85	Colorado	21.75
Florida	20.65	Wyoming	21.75
Maine	20.47	Oregon	21.75
Oklahoma	20.47	South Carolina	21.75
Pennsylvania	19.99	Nevada	21.73
West Virginia	19.95	Arizona	21.68
South Dakota	19.77	Montana	21.63
Nebraska	[illegible]	Maryland	21.30
Minnesota	18.73	Ohio	20.93
New York	18.33	Iowa	20.85
Massachusetts	18.33	Oklahoma	20.47
Maryland	18.00	Pennsylvania	19.99
California	18.00	Massachusetts	19.95
New Hampshire	18.00	Michigan	19.01
Nevada	17.69	Nebraska	18.88
South Carolina	17.29	Minnesota	18.73
Wisconsin	16.82	New York	18.33
Illinois	16.73	California	18.00
Kentucky	16.64	New Hampshire	18.00
Texas	16.57	North Dakota	18.00
New Mexico	16.38	Virginia	17.97
Ohio	15.68	Wisconsin	16.82
Missouri	15.59	Illinois	16.73
Kansas	15.43	Kentucky	16.64
North Carolina	15.00	Texas	16.57
Virginia	14.67	New Mexico	16.38
Alabama	14.45	West Virginia	15.72
Michigan	14.16	Missouri	15.59
Connecticut	12.33	North Carolina	15.00
North Dakota	11.58	Alabama	14.45
Vermont	11.58	Connecticut	12.67
Alaska	11.58	Vermont	11.58
District of Columbia	11.50	District of Columbia	11.60
Arkansas	10.00	Arkansas	10.00
median	18.73	median	20.93
mean	19.04	mean	20.24

Source: Cost of Personal Borrowing in the United States, 1975 and 1979 editions.

Table II

COMPARISON OF AUTO LOAN ANNUAL PERCENTAGE RATES

Based on $6000 Loan to Be Repaid
In Thirty-six Equal Monthly Installments

1975 State	APR	1979 State	APR
Hawaii[1]	24.85	Hawaii[1]	24.85
Virginia[2]	24.00	Virginia[2]	24.00
California	21.20	Nevada	21.20
Nevada	21.20	California	21.20
Rhode Island[3]	21.00	Rhode Island[3]	21.00
Idaho[4]	18.67	Idaho[4]	20.22
Utah[3]	18.67	Utah[3]	20.22
Indiana[4]	18.38	Indiana[4]	19.45
Wyoming[4]	18.11	Wyoming[4]	18.11
Colorado[4]	18.00	Colorado[4]	18.00
Oklahoma[3]	18.00	Oklahoma[3]	18.00
Maryland	16.24	Kentucky	16.24
Kentucky	16.24	Maryland	16.24
North Carolina	16.00	North Carolina	16.00
Kansas[5]	15.88	Kansas[5]	15.88
Alaska	15.11	Alaska	15.11
Iowa	15.00	Iowa	15.00
South Dakota	15.00	Louisiana	15.00
Louisiana	15.00	South Dakota	15.00
Ohio	14.89	Ohio	14.89
Alabama[6]	14.55	Alabama[6]	14.55
Arizona	14.55	Arizona	14.55
District of Columbia	14.55	District of Columbia	14.55
Florida	14.55	Florida	14.55
Georgia	14.55	Georgia	14.55
Illinois	14.55	Illinois	14.55
Massachusetts	14.55	Massachusetts	14.55
Minnesota	14.55	Minnesota	14.55
New Mexico	14.55	New Mexico	14.55
Oregon	14.55	Oregon	14.55
Texas	13.69	Texas	13.69
Maine	13.00	Nebraska[2]	13.65
Mississippi	12.92	Maine	13.00
Connecticut	12.83	Mississippi	12.92
Delaware	12.83	Delaware	12.83
Michigan	12.83	Michigan	12.83
Missouri	12.83	Missouri	12.83
Montana	12.83	Montana	12.83
New Hampshire	12.83	New Hampshire	12.83
New York	12.83	New Jersey	12.83
New Jersey	12.83	New York	12.83
North Dakota	12.83	North Dakota	12.83
South Carolina	12.83	South Carolina	12.83
Wisconsin	12.83	Vermont	12.83
Vermont	12.83	Connecticut	12.75
West Virginia	12.00	Wisconsin	12.75
Washington[7]	12.00	Washington[7]	12.00
Nebraska[2]	11.96	West Virginia	12.00
Pennsylvania	11.08	Pennsylvania	11.08
Arkansas	10.00	Arkansas	10.00
Tennessee[8]	---	Tennessee[8]	---
mean	15.15	mean	15.26

Source.

[1]based on sales finance rates

[2]based on installment sales rates

[3]based on installment sales finance rates

[4]based on consumer sales credit rates

[5]based on consumer credit sales rates

[6]based on installment loans and credit rates

[7]based on installment finance rates

[8]no ceiling on conditional sales agreements, 18 percent for bank auto loans, 22 percent for auto loans from thrifts

Table [illegible]

COMPARISON OF ANNUAL PERCENTAGE RATES FOR REVOLVING CHARGE ACCOUNTS

Based on a [illegible] Average Monthly Balance

1975 State	1975 APR	1979 State	1979 APR
Kentucky[2]	[illegible]	Kentucky[2]	[illegible]
Oregon[2]	[illegible]	Oregon[2]	[illegible]
Utah	[illegible]	New Hampshire[1]	[illegible]
New Hampshire[1]	[illegible]	Nevada	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	Ohio	[illegible]
Ohio	[illegible]	Michigan	[illegible]
Michigan	[illegible]	Kansas	[illegible]
Kansas	[illegible]	Alabama	18.00
Alabama	18.00	Alaska	18.00
Alaska	18.00	Arizona	18.00
Arizona	18.00	California	18.00
California	18.00	Colorado	18.00
Colorado	18.00	Delaware	18.00
Delaware	18.00	Florida	18.00
Florida	18.00	Georgia[3]	18.00
Georgia[3]	18.00	Hawaii	18.00
Hawaii	18.00	Idaho	18.00
Idaho	18.00	Indiana	18.00
Indiana	18.00	Louisiana	18.00
Louisiana	18.00	Maine	18.00
Maine	18.00	Mississippi	18.00
Mississippi	18.00	Montana	18.00
Montana	18.00	New Jersey	18.00
New Jersey	18.00	North Carolina	18.00
North Carolina	18.00	North Dakota	18.00
North Dakota	18.00	Oklahoma	18.00
Oklahoma	18.00	Rhode Island	18.00
Rhode Island	18.00	South Carolina	18.00
South Carolina	18.00	Tennessee	18.00
Tennessee	18.00	Utah	18.00
Virginia	18.00	Virginia	18.00
West Virginia	18.00	West Virginia	18.00
Wyoming	18.00	Wyoming	18.00
Iowa	17.14	Iowa	17.14
District of Columbia	16.29	District of Columbia	16.29
Maryland	16.29	Maryland	16.29
Massachusetts	16.29	Massachusetts	16.29
Nebraska	16.29	Nebraska	16.29
New Mexico	16.29	New Mexico	16.29
New York	16.29	New York	16.29
Texas	16.29	Texas	16.29
Vermont	16.29	Vermont	16.29
Wisconsin	16.29	Wisconsin	16.29
Missouri	15.43	Missouri	15.43
Pennsylvania	15.00	Pennsylvania	15.00
Connecticut	12.00	Connecticut	13.07
Minnesota	12.00	Minnesota	12.00
South Dakota	12.00	South Dakota	12.00
Washington	12.00	Washington	12.00
Arkansas	10.00	Arkansas	10.00
mean	17.82	mean	17.80

Source: Cost of Personal Borrowing in the United States, 1975 and 1979 editions.

[1]based on small loan rates

[2]based on consumer finance rates

[3]based on sales finance rates

TABLE IV

COMPARISON OF AMOUNTS OF LOANS MADE BY
CONSUMER FINANCE COMPANIES AND
ANNUAL PERCENTAGE RATES

State	APRs for a $2500/12 mo loan[1]	Amounts of Loans Made Per Capita[2]
Louisiana	31.08	$222.8
Idaho	25.67	149
Washington	24.69	64.6
Florida	22.80	98.1
Kansas	22.65	110.4
Wyoming	21.70	156.2
Oregon	21.70	126
South Carolina	21.70	170
Arizona	21.68	62.7
Montana	21.60	78.6
Maryland	21.00	107.3
Ohio	20.93	61.4
Iowa	20.85	152
Pennsylvania	19.99	126
Michigan	19.01	39.4
Nebraska	18.88	69.8
Minnesota	18.73	68.7
California	18.00	96
New Hampshire	18.00	74
North Dakota	18.00	53.1
Virginia	17.79	61.9
Wisconsin	16.82	90.3
Illinois	16.73	68.2
Kentucky	16.64	97.9
Texas	16.57	76
North Carolina	15.00	100.7
Alaska	14.45	327
Vermont	11.58	29

[1] Cost of Personal Borrowing in the United States, 1979 edition.

[2] National Consumer Finance Association Report, The Consumer Finance Industry by State and Statute, 1978. (released January 1981)

The 1979 figures used for comparison represent the most recent data available on outstanding credit by state.

TABLE V

COMPARISON OF CONSUMER FINANCE COMPANY
PROFITABILITY AND ANNUAL PERCENTAGE RATES

State	APRs for a $2500/12 mo Loan[1]	Profitability on a Per Capita Basis[2]
Louisiana	31.08	$4.67
Idaho	25.67	0.28
Washington	24.69	1.19
Florida	22.86	-0.25
Kansas	22.65	1.97
Wyoming	21.70	2.78
Oregon	21.70	1.30
South Carolina	21.70	2.97
Arizona	21.68	n/a
Montana	21.60	n/a
Maryland	21.00	n/a
Ohio	20.93	n/a
Iowa	20.85	2.33
Pennsylvania	19.99	1.16
Michigan	19.01	n/a
Nebraska	18.88	0.34
Minnesota	18.73	4.08
California	18.00	4.33
New Hampshire	18.00	0.28
North Dakota	18.00	0.55
Virginia	17.79	0.79
Wisconsin	16.82	1.40
Illinois	16.73	0.54
Kentucky	16.64	1.20
Texas	16.57	1.22
North Carolina	15.00	2.25
Alaska	14.45	2.63
Vermont	11.58	-0.22

[1]Cost of Personal Borrowing in the United States, 1979 edition.

[2]National Consumer Finance Association Report, The Consumer Finance Industry by State and Statute, 1978. (released January 1981)

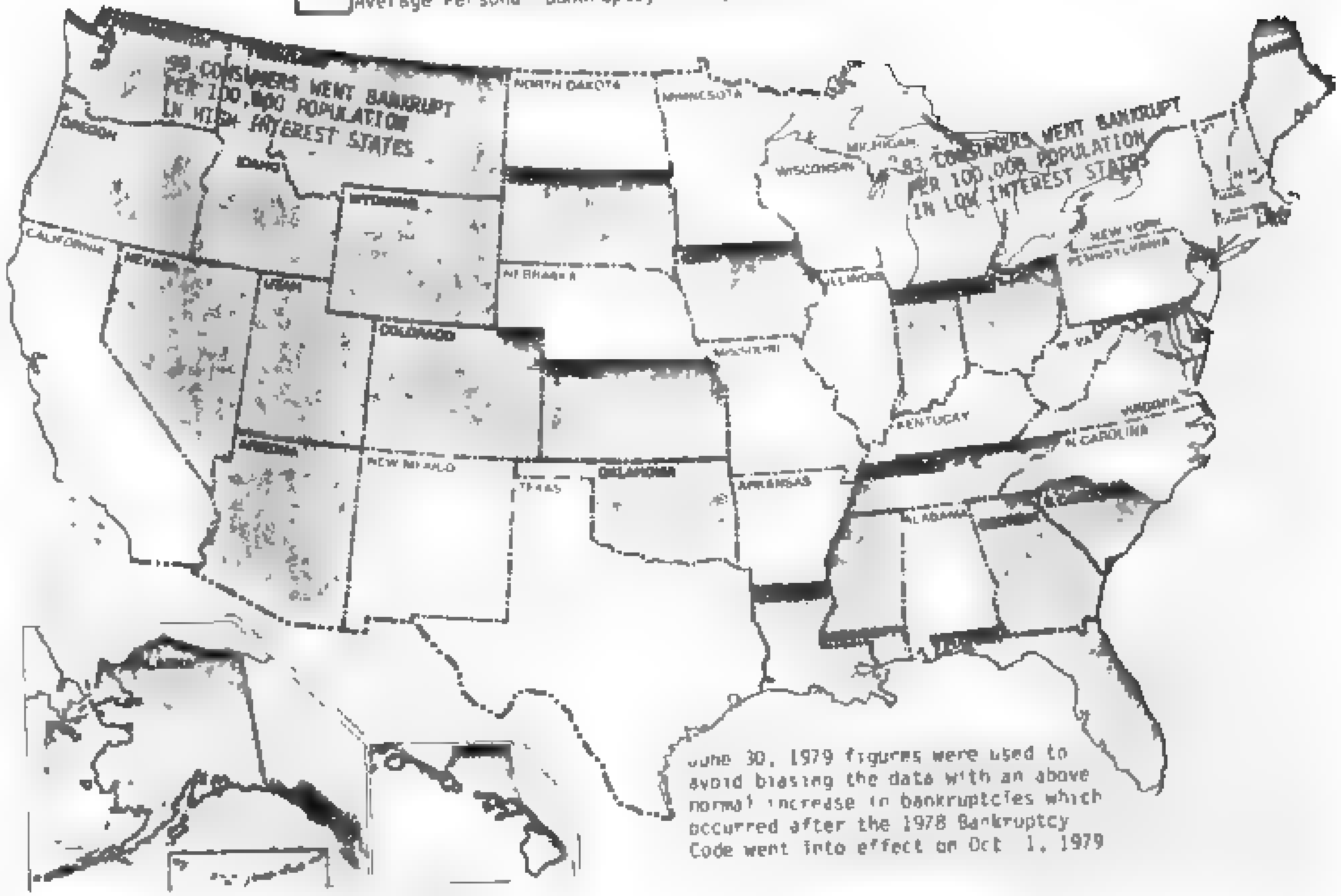
The 1979 figures used for comparison represent the most recent data available on finance company profitability by state.

PERSONAL BANKRUPTCY IN HIGH AND LOW INTEREST RATE STATES
prepared by Consumer Federation of America

U.S. Average Interest Rate on Consumer Loans, 1979 = 20.24%/$2500 Loan, 1 yr
U.S. Average Rate of Personal Bankruptcy, 1979 = 89 per 100,000 population

States with Above Average Consumer Loan Rates.
Average Personal Bankruptcy Rate = 99 per 100,000

States with Below Average Consumer Loan Rates
Average Personal Bankruptcy = 83 per 100,000



June 30, 1979 figures were used to avoid biasing the data with an above normal increase in bankruptcies which occurred after the 1978 Bankruptcy Code went into effect on Oct 1, 1979

Senator TOWER. Thank you very much, Mr. Boyle.
Our next witness is Ms. Ellen Broadman.

STATEMENT OF ELLEN BROADMAN, COUNSEL FOR GOVERNMENT AFFAIRS, CONSUMERS UNION OF THE UNITED STATES

Ms. BROADMAN. Mr. Chairman, I would like to have my entire statement submitted for the record and I will briefly summarize it here.

Senator TOWER. Your full statement will be inserted in the record and you may summarize it as you see fit.

[Complete statement follows:]

STATEMENT OF ELLEN BROADMAN

CONSUMERS UNION WASHINGTON OFFICE

Mr. Chairman and members of the Subcommittee, Consumers Union* appreciates this opportunity to testify on S. 963 and S. 1406. CU strongly opposes both bills.

S. 1406 would preempt all state laws that limit the interest rates and other charges on consumer loans. This sweeping preemption would erase important state laws that protect consumers against noncompetitive and sometimes unconscionable credit rates, yet allow lenders to earn reasonable profits. S. 963, too, would preempt both usury limits and a plethora of other substantive state consumer protection laws. These proposals might well be titled "The Lenders' Dream Act of 1981."

STATE USURY CEILINGS SERVE A VALUABLE FUNCTION AND SHOULD NOT BE ABOLISHED

Usury ceilings protect consumers against exorbitant interest rate charges. In credit markets that are not truly competitive, usury ceilings prevent lenders from charging excessive interest rates and otherwise from taking advantage of captive purchasers. Usury ceilings also protect

* Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of Consumer Reports, its other publications, and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with over 3 million circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

unsophisticated and uninformed consumers from interest rates that exceed market rates to an unconscionable degree. In states that recently have eliminated usury ceilings, abuses already are coming to light. According to the staff of the Arizona Banking Department, consumers in Arizona (which recently eliminated usury limits) are unknowingly giving second deeds of trust with effective interest rates that exceed an annual percentage rate of 100 percent. State laws limiting interest rate charges for consumer credit tend to offer protections highly valued by consumers.

Federal preemption of all consumer usury laws would drastically and inappropriately intrude into an area traditionally regulated by the States. Federal laws should preempt state law only if it is clear that in no other way can the public be adequately protected. By this test, S. 1406's blanket preemption of state laws is unjustified.

It is true that artificially low ceilings discourage lending and reduce the availability of credit. Neither consumers nor lenders are well served by unduly low ceilings. But, since December, 1978, 34 states have raised or abolished outdated interest rate limits. Others are now reviewing their rates and may make further revisions.

The few states with low ceilings--Arkansas has the most extreme limit--strongly believe that low ceilings protect their citizens. Indeed, in Arkansas voters have repeatedly chosen to

retain the 10 percent usury ceiling written into the state constitution. A federal override of the will and the constitution of the people of Arkansas should be viewed as unfounded federal paternalism.

The sweeping preemption proposed in S. 1409 is particularly offensive because it abolishes all interest rate ceilings even those that are clearly reasonable. States that have set usury limits substantially above market rates, to allow lenders ample return while preventing egregiously high charges, would be subjected to the preemption provisions of S. 1409. Criminal usury statutes directed at lenders who assess grossly unconscionable interest rates, in some cases exceeding 50 or 60 percent, would be abolished by S. 1406. There is no evidence that these laws create problems either for legitimate lenders or for borrowers. Federal preemption of these state laws would raise new and troubling questions about the balance of powers between the Federal and state governments. This Subcommittee should reject such an unreasoned abolition of state laws.

Federal preemption, quite predictably, would increase defaults and abusive creditor practices. Without usury ceilings, lenders would have every incentive to engage in more aggresive credit promotion and solicitation schemes to expand credit use and profits. They would be willing to lend to less creditworthy individuals because of the higher potential profit on each credit transaction. As increasing numbers of less

creditworthy individuals obtain credit at higher rates, defaults will occur with greater frequency. States with low usury ceilings, which restrict consumer credit, have not found it necessary to adopt consumer protections against numerous abusive creditor practices.1/ Consumers in these states will be at a serious disadvantage if preemption rapidly increases credit use, defaults, and creditor abuses.

For this reason, any elimination, however ill-advised, of state usury laws ought to be accompanied by strong consumer protections against unfair and unscrupulous practices engaged in by creditors. The Fair Debt Collection Practices Act should be extended to cover creditors who collect their own debts and such creditors' attorneys. As it stands, this law merely bans offensive debt collection practices by debt collection agencies. In addition, consumer protections against unfair default provisions, in effect only in some states, should be adopted on a Federal level. Wage assignments, which allow lenders to seize borrowers' wages without any procedural safeguards or even cursory judicial scrutiny, should be prohibited. Confessions of judgment, which waive consumers' right to notice and the opportunity to be heard before judgment

1/ Several of these abuses which are prohibited in some states, although not in others are described in Federal Trade Commission, Bureau of Consumer Protection, Credit Practices, Staff Report and Recommendation on Proposed Trade Regulation Rule (August 1980).

is entered against them, similarly should be banned. Various other unfair creditor practices cited in the Federal Trade Commission staff report on the Credit Practices Rule 2/ also should be prohibited.

Federal preemption would also need to be accompanied by restrictions on hidden, inequitable fees now assessed by creditors to increase their rate of return without exceeding usury ceilings. The Rule of 78's method of determining finance charge rebates when a loan is prepaid should be prohibited. This calculation method substantially penalizes consumers who prepay loans toward the beginning of the loan term. Rather than reap profits from hidden, unfair fees, lenders should include these charges in the Finance Charge and Annual Percentage Rate. This will enable credit shoppers to understand the true cost of credit and compare alternative credit arrangements. S. 1406 fails to provide any consumer protections that would address the problems it would create or to require that credit charges be equitable.

STATE CONSUMER PROTECTION LAWS SHOULD NOT BE PREEMPTED

S. 963 and S. 1406 also would preempt an array of substantive consumer protection laws that do not directly control interest rate charges. Under S. 1406, all laws that

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2/ See 1/.

restrict charges arising out of a consumer credit agreement would be eliminated. Only credit-related charges that become due when a borrower fails to comply with the credit contract would remain subject to state regulation. Under S. 963, all state laws that limit "compensation, however denominated for a loan" would be preempted. Under both bills, state restrictions on charges for credit insurance and on the use of the Rule of 78's would be eliminated.3/ These state restrictions were adopted to redress serious, well-documented, widespread creditor abuses. For the Federal government to sweep away such carefully considered state laws under the guise of preempting usury ceilings would be unjustified. Should Congress elect the drastic step of preempting state laws, that preemption should be drafted as narrowly as possible to apply only to those credit charges, excluding credit life insurance, included in the Annual Percentage Rate as defined by the Truth in Lending Act. These charges are a part of the interest rate, which S. 1046 attempts to free from restrictions. This limited preemption would enable creditors to charge whatever interest rate they choose, while allowing the states to control other credit practices based on fairness, equitability, or consciounability.

3/ Although the section-by-section summary for S. 1406 states that state laws which restrict the use of the Rule of 78's would not be preempted, we find no support for this assertion in the language of S. 1406. By limiting the preemption to charges included in the APR, the Subcommittee would bring S. 1406 into conformity with the intentions stated in the summary.

STATES SHOULD BE GIVEN AN OPPORTUNITY TO REJECT FEDERAL PREEMPTION

Under S. 1406, state laws would be preempted on the date of enactment of S. 1406. Within three years after that date, the state could reinstate state usury ceilings. However, those states which failed to opt out of the Federal preemption within three years could never again adopt state usury ceilings for consumer credit.

If Congress proceeds to preempt state usury ceilings, states should be given an opportunity to veto federal preemption. A federal preemption should not become effective for at least two years after enactment, to allow state legislatures to act.

Moreover, states ought to be able to reinstate their own usury ceilings at any time. Those states with no usury ceilings may fail to opt out of the federal usury preemption within the next three years. After that time, if interest rate abuses arise, these states would be unable to adopt rate ceilings to remedy local consumer problems. The states should not be bound by an arbitrary three-year deadline.

SUMMARY

In conclusion, Consumers Union urges this Subcommittee to reject both S. 963 and S. 1406. Most states have revised their rate limits to accommodate current economic conditions; those that have retained low ceilings do so because of strong, considered sentiments. The proposed abolition of rate ceilings

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would be an unnecessary and unreasonable intrusion on the rights of the people of those states to protect their consumers. Further, the proposed Federal preemption could unleash an onslaught of defaults and abusive debt collection practices without providing adequate consumer protections. Taken together, the proposals before this Subcommittee are unnecessary, undesirable, and harmful to consumers.

Senator TOWER. Thank you, Ms. Broadman.
Mr. Schechter.

STATEMENT OF HENRY SCHECHTER, DIRECTOR, AFL-CIO OFFICE OF HOUSING AND MONETARY POLICY

Mr. SCHECHTER. Mr. Chairman and members of the committee, I appreciate the opportunity to present before you the views of the AFL-CIO on S. 1406 and S. 963 dealing with consumer credit deregulation.

I, too, would like to summarize my prepared statement but ask that the full statement be included.

Senator TOWER. Your full statement will be included in the record.

Mr. SCHECHTER. Thank you.

The AFL-CIO has frequently adopted positions concerning the level of interest rates and availability of credit for different purposes. Fluctuations in these important economic conditions affect the condition the economy and the cost of living which our working people must face. It is from this perspective that our views are offered on the legislation under consideration.

The two bills that are being considered would amend, extend and add to the Federal preemption of State interest rate ceilings that was enacted in 1980. The removal of State ceilings on mortgage loan and business and agricultural loan interest rates 15 months ago was supposed to remove distorting and economically damaging impacts in those economic sectors. The record of experience in the affected sectors, therefore, can provide some notion as to the impacts, if any, of Federal preemption.

IMPACT OF CREDIT CONTROL REMOVAL

In the 3 months after the 1980 act was signed, under the combined influence of an economic recession and an application of credit controls, mortgage interest rates declined, downtrends in home sales and in new housing starts bottomed out, and homebuilding began to lead the economy out of a recession. However, with the economic upturn, removal of credit controls and tight monetary policies, interest rates climbed, with mortgage rates reaching a 15 percent rate and the prime rate 21.5 percent by the end of 1980. Such interest rates remained at relatively high levels in the first half of 1981. The interest-rate sensitive homebuilding

and auto industries have been severely depressed, and the economy as a whole is weakening. In the last 9 months of 1980, the post-preemption period, the number of business bankruptcies were 67 percent higher than in the comparable 1979 period, and the number is still rising in 1981.

The experience of the housing and business sectors following the removal of State interest rate ceilings indicates that they did not exert a significant adverse economic impact. They had been made the scapegoat for rising interest rates which caused people to restrict large credit financed purchases and also directly depleted the capital of many businesses. The removal of interest rate usury ceilings permitted interest rates to be ratcheted up to higher levels at a faster pace, exacerbating the adverse impacts.

In a tight money situation such as we have credit is extended in a seller's market. That is, the people who extend credit can sort of auction it off when it's available and obtain higher and higher rates, and this is what we have been experiencing, rather than any impact of ceiling rates which, as indicated, in areas that have been badly hurt were lifted 15 months ago.

S. 963 would provide that any State statutory or constitutional ceiling below a formula ceiling rate, that presently would be 19 percent, could be overridden. The bill is designed to preempt the Arkansas State constitutional ceiling of 10 percent, which is still applicable to consumer credit in that State. That constitutional provision has been in effect for 107 years. It was adopted in 1874, after the 1873 financial panic in which interest rates of 60 percent were not uncommon. Several proposals to have the 10-percent ceiling rate raised or eliminated by referenda and constitutional conventions have been voted down by the people of Arkansas. The State has enjoyed good long-term economic growth, as the absence of high-cost debt burdens has more than compensated for temporary slowdowns in high interest rate periods. Even in the current high interest rate period, the people of Arkansas are being served by local and national merchants that provide 10-percent credit financing. Some illustrative recent Arkansas advertisements are appended to this statement.

The people of Arkansas have voted four times in the last years to bar credit above 10 percent and its burdensome aftermath in their State. They should not be forced to abandon their chosen, apparently successful course. The AFL–CIO urges disapproval of S. 963.

I think the Arkansas experience also illustrates a recognition by the people of Arkansas that when higher rates can be charged in a State, all the rates are likely to rise as people who wish to borrow for different purposes bid for funds at higher rates. As a consequence, the higher rate structure gets passed through into all the costs of business and what consumers must pay. Therefore, it is their form of collective bargaining with lenders particularly and with merchants which they adopted over 100 years ago saying, "If you wish to have credit costs more than 10 percent, we refuse to use it."

The Arkansas experience is also relevant to consideration of S. 1406, which would preempt State ceilings on consumer loan interest rates. The long-run Arkansas experience refutes the allegation that usury ceilings depress a State economy.

CREDIT RATIONING

The most critical issue raised by advocates of preemption of consumer loan rate ceilings is that ceilings start a process of credit rationing in which the least qualified borrowers find it difficult to secure credit. This effect would be much greater under the market forces of price rationing in a tight money-high interest rate environment that we presently have. If a person can't qualify for a loan at 10 or 12 percent, he's certainly not going to qualify for a loan at 18 or 20 percent. Even without preemption, some States have no ceiling rates for certain types of consumer loans, and some ceilings permit charges with 44 and 51 percent annual interest rates, but as some of my colleagues a the table indicated, actually much higher rates are being charged. Can higher rates be helpful? Given the outlook for tight money-high interest rates and high unemployment, federal preemption in the consumer credit area would exacerbate the hardships to business and individuals from higher rates, taking us back toward 1873. The AFL-CIO urges disapproval of S. 1406.

[Complete statement follows:]

STATEMENT OF HENRY B. SCHECHTER, DIRECTOR
OFFICE OF HOUSING AND MONETARY POLICY, AFL-CIO
ON CREDIT REGULATION AND DEREGULATION
PROPOSED IN S.1406 AND S.963
BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

July 15, 1981

I appreciate the opportunity to present before you the views of the AFL-CIO on S.1406, the Credit Deregulation and Availability Act of 1981 and S.963, to amend Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980.

The AFL-CIO has frequently adopted positions concerning the level of interest rates and availability of credit for different purposes. Fluctuations in these important economic conditions affect the condition the economy and the cost of living which our working people must face. It is from this perspective that our views are offered on the legislation under consideration.

With your permission, I would like to summarize my prepared statement, but ask that the full statement be placed in the record.

<u>Summary</u>

The two bills that are being considered would amend, extend and add to the Federal preemption of state interest rate ceilings that was enacted in 1980. The removal of state ceilings on mortgage loan and business and agricultural loan interest rates 15 months ago was supposed to remove distorting and economically damaging impacts in those economic sectors. The record of experience in the affected sectors, therefore, can provide some notion as to the impacts, if any, of Federal preemption.

In the three months after the 1980 act was signed, under the combined influence of an economic recession and an application of credit controls, mortgage interest rates declined, downtrends in home sales and in new housing starts bottomed out, and homebuilding

began to lead the economy out of a recession. However, with the economic upturn, removal of credit controls and tight monetary policies, interest rates climbed, with mortgage rates reaching a 15 percent rate and the prime rate 21½ percent by the end of 1980. Such interest rates remained at relatively high levels in the first half of 1981. The interest-rate sensitive homebuilding and auto industries have been severely depressed, and the economy as a whole is weakening. In the last 9 months of 1980, the post-preemption period, the number of business bankruptcies were 67 percent higher than in the comparable 1979 period, and the number is still rising in 1981.

The experience of the housing and business sectors following the removal of state interest rate ceilings indicates that they did not exert a significant adverse economic impact. They had been made the scapegoat for rising interest rates which caused people to restrict large credit financed purchases and also directly depleted the capital of many businesses. The removal of interest rate usury ceilings permitted interest rates to be ratcheted up to higher levels at a faster pace, exacerbating the adverse impacts.

S.963 would provide that any state statutory or constitutional ceiling below a formula ceiling rate, that presently would be 19 percent, could be overridden. The bill is designed to preempt the Arkansas state constitutional ceiling of 10 percent, which is still applicable to consumer credit in that state. That constitutional provision has been in effect for 107 years. It was adopted in 1874, after the 1873 financial panic in which interest rates of 60 percent were not uncommon. Several proposals to have the 10 percent ceiling rate raised or eliminated by referenda and constitutional conventions have been voted down by the people of Arkansas. The state has enjoyed

good long-term economic growth, as the absence of high-cost debt burdens has more than compensated for temporary slowdowns in high interest rate period. Even in the current high interest rate period, the people of Arkansas are being served by local and national merchants that provide 10 percent credit financing.

The people of Arkansas should not be forced to abandon their chosen, apparently successful course. The AFL-CIO urges disapproval of S.963.

The Arkansas experience is also relevant to consideration of S.1406, which would preempt state ceilings on consumer loan interest rates. The long-run Arkansas experience refutes the allegation that usury ceilings depress a state economy.

The most critical issue raised by advocates of preemption of consumer loan rate ceilings is that ceilings start a process of credit rationing in which the least qualified borrowers find it difficult to secure credit. This effect would be much greater under the market forces of price rationing in a tight money-high interest rate environment that we presently have. Even without preemption, some states have no ceiling rates for certain types of consumer loans, and some ceilings permit charges with 44 and 51 percent annual interest rates. Given the outlook for tight money-high interest rates and high unemployment, Federal preemption in the consumer credit area would exacerbate the hardships to business and individuals from higher rates, taking us back toward 1873. The AFL-CIO urges disapproval of S.1406.

Impacts of Federal Rate Preemptions

The Credit Deregulation and Availability Act of 1981, S. 1406 is proposed to complete the process that was begun by enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980. The 1980 Act preempted State interest rate ceilings on mortgage loans permanently, and on business and agricultural loans for a three year period. Under S. 1406, the Federal preemption of business and agricultural loans would become permanent and state ceilings on consumer loans would also be preempted. All of the Federal preemptions may be made inapplicable in a state by an action of the state legislature.

It has been stated that Federal preemptions of state interest rate ceilings were enacted in 1980 because Congress saw the distorting and economically damaging impact that state home mortgage interest rate ceilings were having on buyers, sellers and builders of homes, and there was a similar view of the business and agricultural credit situation. Since the Federal preemptions in those sectors became effective on March 31, 1980, there is now a 15 month record of experience which should reflect this impact.

What has happened during the fifteen months since the state interest rate ceilings on mortgage, business and agricultural loans

were removed? The pattern of mortgage interest rates, home sales and housing starts can be followed in Table 1, below. In the three months after the Depository Institutions Deregulation Act was signed, under the combined influence of an economic recession and a modest application of credit controls, mortgage interest rates declined, the downtrends in new and existing home sales and in housing starts bottomed out. Homebuilding began to lead the economy out of a recession.

However, as the economy began a recovery,(which was never completed) the credit controls were lifted and there was a turn to an increasingly restrictive monetarist policy which soon set mortgage interest rates on an upward trend. Home sales began to decline in the latter months of 1980, the starts rate took a nosedive in February 1981 and have remained depressed since then.

Business loan interest rates also were affected by the recession and credit controls of 1980. The prime rate charged by banks hit a peak of 20 percent on April 2, 1980, subsequently declined to 11 percent by July 25, then climbed to 21.5 percent by late December. (During 1981 the prime rate has fluctuated between 20½ and 17 percent). A comparison of the number of business bankruptcies in the last 9 months of 1980, after Federal premption of loan rate ceilings , with the number during the last 9 months of 1979, shows a 67 percent increase in 1980 over 1979. In the first month of 1981 there was a 52 percent increase over the first month of 1980.

Table 1 - Home Mortgage Interest Rates, Sales and Starts

Month	Conventional New Home Mortgage Loan Commitment Effective Interest Rates[a]	Seasonally Adjusted Annual Rates (in thousands of units) New Homes Sold[b]	Existing Homes Sold[c]	New Units Started[d]
1980: March	14.78	470	2,830	1,040
April	16.65	353	2,470	1,044
May	15.65	471	2,350	938
June	13.23	532	2,570	1,144
July	12.46	625	2,920	1,277
Aug.	12.48	616	2,970	1,411
Sept.	13.22	563	3,280	1,482
Oct.	13.85	549	3,120	1,519
Nov.	14.21	560	2,960	1,550
Dec.	14.90	514	2,910	1,535
1981: Jan.	15.38	523	2,580	1,660
Feb.	15.33	507	2,560	1,215
March	15.46	510	2,490	1,297
April	15.50	436	2,610	1,340
May	16.10	504p	2,510p	1,162p
June	16.75p	n.a.	n.a.	n.a.

n.a. - not available
p - preliminary

a/25 years maturity, 75% loan-to-value ratio, source: Federal Home Loan Bank Board

b/source: Bureau of the Census and Department of HUD

c/source: National Association of Realtors

d/source: Bureau of the Census

The pre- and post-preemption experience in sectors financed with mortgage and business loans suggests the state interest rate ceilings did not exert a significant adverse economic impact. The influence of Federal Reserve monetary policy upon interest rates and upon home and auto buyers and the viability or mortality of businesses in residential construction, commerce and industry was much greater. This had certainly been indicated by the entire post-World War II history of the role of monetary policy in credit and business cycles. Confirmation was provided by the 1979-81 experience, before and after Federal preemption of rate ceilings.

The removal of state interest rate ceilings removed a scape-goat. Without the ceilings, as interest rates in recent months climbed back to where they were about fifteen months ago, great weakness was again felt in housing and auto markets, more businesses are failing and the entire economy is becoming soft. If anything, the removal of usury rate ceilings has permitted interest rates to be ratcheted up to higher levels at a faster pace, as competition for funds for different uses became more permissive.

Apparently, some other changes than Federal preemption are needed to help remove the causes of economic instability and damage that take place with reliance upon monetary policy as the sole regula-tory tool.

S. 963 a "special case" Bill

Both of the bills under consideration address themselves to Federal preemption of state consumer loan interest rate ceilings. S. 963 is a selective, "special case" bill, really applicable to one state. However, the circumstances which gave rise to that bill can also throw some light upon the considerations involved in the more broadly applicable Federal preemption proposed in S. 1406.

S. 963 would provide that, notwithstanding any state constitutional or statutory provision, the interest rate on any loan in any state could be the higher of either a formula ceiling provided in the bill or a higher rate that would be permitted in the absence of that formula rate, meaning any higher state ceiling or the absence of any ceiling as under the proposed S. 1406 preemption. The formula rate ceiling would be the Federal Reserve discount rate, curently 14 percent, plus 1 percentage point plus any current surcharge on the discount rate, currently, 4 percent; providing a 19 percent ceiling.

The only state with a constitutional loan interest rate ceiling below 19 percent is Arkansas, where a constitutional usury rate ceiling of 10 percent has prevailed for 107 years, after it was adopted in 1874. That was the year following the 1873 financial panic when, as described in a 1906 paper prepared for the Arkansas Bankers Association,"in 1873 and the early part of

1874 the rate had risen until 24 percent per annum was considered reasonable and more frequently 60 percent per annum was given." During the 107 years in which the 10 percent constitutional ceiling rate has remained in effect, there have been several attempts through constitutional conventions and special referenda to raise or eliminate the 10 percent ceiling rate. Each time the people of Arkansas have voted to retain the 10 percent ceiling.

Despite the fact that there will be a special referendum on the 1982 general elections ballot in Arkansas, proposing to change the ceiling from 10 to a maximum of 17 percent, S. 963 has been introduced in the U.S. Senate. It is an end-run around the repeated, expressed will of the people of Arkansas.

There is evidence which vindicates the economic good sense of the people of Arkansas. Arkansas which is still largely an agricultural state, but growing industrially, has been catching up with the U.S. in personal income on a per capita basis, which adjusts for the changes in population. As a percentage of the U.S. per capita personal income, the Arkansas per capita personal income increased from 62 percent in 1958 to 78 percent in 1979. Over that same period, while U.S. nonagricultural employment increased by 46 percent, the comparable increase in Arkansas was 104 percent.

Apparently the 10 percent usury ceiling did not result in stifling consumer demand and economic growth. Arkansas has not suffered as great a drain of expendable income due to very high interest rates as other states have.

Table 2 - Per Capita Personal Income

United States and Arkansas

1958-79

Year	Per Capita Personal Income in the U.S.	Per Capita Personal Income in Arkansas	Arkansas Per Capita Personal Income as Percent of U.S. Personal Income
1958	$ 2,050	$ 1,277	62.2
59	2,145	1,363	63.5
60	2,201	1,358	61.7
61	2,248	1,455	64.7
62	2,353	1,516	64.4
63	2,436	1,594	65.4
64	2,572	1,713	66.6
65	2,750	1,832	66.6
66	2,963	2,046	69.1
67	3,142	2,176	69.3
68	3,401	2,379	70.0
69	3,667	2,569	70.1
70	3,893	2,791	71.7
71	4,132	2,999	72.6
72	4,493	3,302	73.5
73	4,981	3,822	76.7
74	5,428	4,274	78.7
75	5,861	4,527	77.2
76	6,402	4,945	77.2
77	7,042	5,743	82.0
78	7,836	5,969	76.2
79	8,706	6,785	77.9

Source: U.S. Department of Commerce

In fact, because they do not assume high interest loans during the tight money, high interest rate periods, Arkansas consumers have less of a drain upon their future incomes than those in other states. Arkansas, therefore, has tended to suffer less during the recessions which follow the high interest rates, and to bounce back more readily. The state has enjoyed above-average long term growth as indicated by data on per capita personal income and growth in non-agricultural employment.

The constitutional 10 percent interest rate ceiling has, in effect, been collective higgling and bartering by the people of Arkansas, telling the banks that they will forego the use of credit when rates are above that limit. And, apparently, that position is still serving the people of Arkansas well.

Last week, the local department store chain (Dillard's) in the Little Rock area was featuring easy credit as available to its customers - at 10 percent. An Arkansas furniture store chain (Brandon House), which does most of its business on a cash basis, but also has 10 percent credit available, is building a huge new additional store. The major hardware store in Little Rock (Handy Dan's) has been soliciting credit card (10 percent) accounts by telephone. Sears, Penny's and Wards extend credit at 10 percent in Arkansas, and they advertise merchandise at prices that are applicable in other states as well as Arkansas.

Arkansas auto dealers situated near the Tennessee state boundary

are in competition with nearby dealers in Memphis. They advertise that they have 12 percent financing available, although such financing may be provided only by major American auto manufacturing subsidiaries for their own make.

Since the people of Arkansas have seen fit to retain a 10 percent limit on consumer credit interest rates and have enjoyed long-term economic growth through retention of this policy, it would be an imposition upon their right to guide their economic destiny to have Federal preemption of consumer loan interest rates. The AFL-CIO urges the Committee to disapprove S. 963.

<u>Proposed New Federal Preemption of Interest Rate Ceilings on Business and Agricultural Loans</u>.

The current Federal preemption of state ceilings on business and agricultural loans interest rates would be amended by S. 1406. Present Federal statutory provisions enacted in 1980, preempt for three years state usury ceilings on commercial and agricultural loans, and establish a Federal limitation on interest rates to be charged on such loans. It is the higher of the state ceiling or 5 percentage points above the Federal Reserve discount rate, plus any surcharge thereon. That formula rate - presently 23 percent - is roughly in line with the present prime rate of 20½ percent. Even with that rate structure, business bankruptcies have been on a rising trend. Removal of even that ceiling, coupled with the outlook for continued tight monetary policy is to invite further escalation

of interest rates as lenders can auction off scarce credit funds to the highest and strongest bidders. It will result in even more failures of businesses - and probably also farmers - and more unemployment. As the deterioration gathers momentum in a highly interdependent economy, it will become increasingly difficult to turn it around.

The braking effect of some ceiling on rates that will hold back the devastating effects of unreasonably high interest rates is sorely needed. If there is to be Federal preemption of state business and agricultural loan interest rate ceilings, there should also be an exercise of Federal responsibility to keep them from rising to destructive levels. An appropriate ceiling rate should be included in the statute.

Federal preemption would be made permanent under S. 1406, unless a state within three years exercised a statutory option to override the Federal preemption and resume control over interest rate ceilings. Since there is no known contemplation that the high interest rates which gave impetus to the temporary Federal preemption will continue for more than 3 years, there is no justification for making the preemption permanent.

It took the Federal government 200 years to decide to preempt the states powers of interest rate regulation. Why should the states have to make up their minds in only three years whether Federal non-regulation is better than state power to regulate or not regulate?

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At the present time, under the option provided in the 1980 Financial Institutions Deregulation Act, Federal preemptions of state usury laws have been overturned in whole or in part in Hawaii, Iowa, Puerto Rico, Kansas, Minnesota, Colorado, Massachusetts, South Carolina and South Dakota. Most of these are "general overrides" applicable to all kinds of loans. Most, though not all, of these overrides take effect immediately. In a few cases they will not take effect until the end of this year. It is difficult for busy state legislatures with very short sessions to take up and act upon legislation to override a Federal law. If there is to be Federal preemption of state interest rate ceilings, beyond the present expiration date of April 1, 1983, the option for states to override should be permanent.

Federal preemtion of state consumer credit interest rate ceilings.

The wholly new Federal preemtion action proposed in S. 1406 is with regard to state consumer credit interest rate ceilings. Any state prohibitions, limitations or restrictions upon the rate, nature, type, amount or manner of calculating of charges would be made inapplicable to an extension of consumer credit.

Although the states would still be permitted to regulate consumer protection, the most vital protection, with regard to rates and charges, would be precluded entirely.

Many of the reasons that have been given for the abolition of consumer credit interest rate ceilings are open to serious question. Perhaps the most critical issue is raised by the claim that consumers would be better served by removal of usury ceilings, since such ceilings "start a process of credit rationing where the least qualified borrowers find it increasingly difficult to secure credit."

In the absence of usury ceilings, in a tight money-high interest rate environment, such as we presently have, as interest rates move up, the least qualified borrowers would become even less qualified, and would find it even more difficult to obtain credit. To leave credit rationing entirely to market forces, which is really rationing by price, is to rule out considerations of need. Those of lower income and credit standing, and those who need small loans involving higher administrative costs per loan dollar, would be forced out of the market when rates shoot up.

The claim that certain types of financial institutions cannot actively engage in profitable consumer lending, given current money costs and state ceilings, is no reason to raise those ceilings. The institutions are chartered to serve the people, not vice-versa.

The claim that usury ceilings have a generally depressant effect upon the economy of a state is highly questionable in the light of more than a century of experience in Arkansas which has a 10 percent constitutional interest rate ceiling. The state has grown and prospered.

It certainly would not benefit the economy of any state or of the nation to go back to the Arkansas days of 1873 when 60 percent interest rates were not uncommon. And yet, even under present state regulation, there are consumer loan ceilings with charges that translate into annual percentage rates of 44 percent and 51 percent, and a number of states have no maximums for certain types of consumer loans. To remove the state ceilings in tight credit market, which is a sellers market, could very well lead to 60 percent annual rates of interest.

Even with the ceilings, the combination of high interest rates

and high unemployment has been producing an increase in non-business or personal bankruptcy filings. In 1980 there was an unusually large 60 percent increase in the annual number of non-business debtors filing bankruptcy petitions in the United States. This was due, in part, to a new (1978) bankruptcy law becoming effective for the first time, as well as to high interest rates and unemployment. However, comparable figures showed a 33 percent increase in the number of people filing for bankruptcy in the first quarter of 1981 over the first quarter of 1980.

Given the skewed distribution of interest income toward the higher income levels, and the extended additional drain upon purchasing power where higher interest rates prevail, ceilings that help to maintain interest rates at more affordable levels are a method of keeping a reasonable economic balance that helps to sustain economic growth. The states have each established limits to serve those purposes under the influence of the various interest groups in their jurisdictions. The Federal government should not intervene to preempt this established economic and political balance. Federal preemption of consumer loan interest rate ceilings, that would take us back toward 1873, should not be enacted.

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ARKANSAS GAZETTE, Saturday, July 4, 1981

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Senator TOWER. Thank you, Mr. Schechter. I think this is one of the most interesting issues that's come before this committee as it cuts across philosophical lines with everybody taking a pragmatic approach. We have had legislators with distinguished records for liberal social legislation, consumer legislation, testify in favor of the substance of these measures.

I'm aware of the fact that automobile dealers are very interested in this legislation and would like to see it passed. It occurs to me that is probably one of the most depressed industries in the United States, with the highest rate of unemployment. I could be incorrect on that, but at least that's the appearance, and I note that auto sales are down this month at the lowest rate on a monthly basis in a year.

I wonder if you would comment on that, Mr. Schechter.

Mr. SCHECHTER. Yes. I think perhaps the biggest problem the auto dealers have is financing their floor inventory and when they have to pay high interest rates, many of them above prime, I think that is what is hurting and makes it very difficult.

They have been through slow sale periods before, but I think that hurts most. What they have to pay in the way of interest where the ceiling had been taken off on business loans.

As far as the industry most depressed, I don't know whether it's autos or construction, but at this time we have 16.6 percent of the construction trades unemployed.

I would say in both cases, it is primarily the tight money, high interest rate levels, and, incidentally, I'm sure this committee is most concerned with the savings and loans situation where, again, as long as we continue to have high interest rates that we have, the situation gets more and more serious.

INTEREST RATES OF 200 PERCENT

Senator TOWER. Mr. Boyle, can you cite examples of the high interest rate loans that you mentioned—100, 200 percent? Can you cite examples of those?

Mr. BOYLE. Yes. There have been numerous such loans, for example, in Arizona, which about a year and a half ago deregulated their interest rates and their charges. It happens in this mechanism where you start buyers on a small monthly payment and then you give them a payment after a couple years of building more equity up in their home or their purchase, then you have them pay a balloon. Of course, they can't afford it and they don't want to lose their home, so they're stuck with whatever rate they wish to charge.

There's a recent study in New York by the New York Banking Commission which looked at appliance dealers where they found rates as high as 208 percent here recently in the first few months after deregulation in the State of New York.

There are numerous examples in the very short period of time we have seen deregulation there. There are many large segments of the economy today that are not competitive. The 1972 National Commission on Consumer Finance recognized that fact. The 10 years I spent in Texas looking at mobile home loans, looking at finance company loans, and talking recently to credit commission-

ers around the country indicated that in certain segments of the market there is very little competition.

Senator TOWER. Aren't a lot of those high interest rate loans, though, short-term loans, so when you annualize the interest it does come out at a very high rate, but ordinarily don't these short-term loans include costs of origination, which are in fact necessary for making the loans?

Mr. BOYLE. Well, I think you'll have some—certainly that's true in some short-term loans. Some of these home improvement loans are rather lengthy and I think some of them run as long as 5 years. So you'll have what we term generally as a longer term loan that will fall into this kind of category.

Senator TOWER. Ms. Broadman, you mentioned the fact that this legislation or legislation similar to it in various States has resulted in a lot of hidden costs and charges and that the uninformed consumer is unprotected. Twelve years ago we reported out of this committee and enacted by the Congress a truth-in-lending bill, and we spent millions of dollars to provide information to the consumers on the cost of credit.

I might note that the Federal Reserve Board's 1977 consumer credit survey showed that truth-in-lending vastly increased consumers' awareness of credit costs and it stated awareness continues to be high among the public as a whole.

Do you have any comment on that?

HIDDEN PREPAYMENT PENALTIES

Ms. BROADMAN. Yes, I certainly do. I was referring to fees, such as prepayment penalties. We view these as hidden fees because they are very steep fees charged when you pay off your loan early so that the fee is not included in the annual percentage rate disclosed when the consumer shops for a loan. The consumer doesn't really find out about this charge until later on during the long term.

Under the new revised truth-in-lending requirements, prepayment penalties are not required to be disclosed in the truth-in-lending statement. We are encouraging this committee to look at the possibility of prohibiting fees that are considered by many States or some States to be unfair charges that are not included in the APR. Then all charges for consumer credit would be then included in the financial charge and reflected in the APR which consumers are aware of.

As the Federal Reserve Board study demonstrated, consumer awareness of APR is increasing significantly since truth-in-lending was passed.

Senator TOWER. I think my time has expired. I will now turn you over to the tender mercies of Senator Proxmire.

Senator PROXMIRE. This is a very expert panel. Can anybody on this panel tell me how many States still have usury statutes of any kind?

Ms. BROADMAN. I would like to introduce into the record a study prepared by the Wisconsin office of the Commissioner on Banking. They recently completed a nationwide survey of usury ceilings that I would be happy to provide to you.

Senator PROXMIRE. Can you tell me how many States have usury statutes?

Ms. BROADMAN. That depends on the kind of usury statute you're referring to.

[The Wisconsin study is reprinted as follows:]

July 7, 1981

MAXIMUM FINANCE CHARGE RATES FOR FIRST LIEN REAL ESTATE MORTGAGE LOANS, CLOSED END CREDIT, OPEN END CREDIT, AND FINANCE COMPANIES IN ALL 50 STATES TOGETHER WITH PROPOSED LEGISLATIVE AMENDMENTS

PREPARED BY THE WISCONSIN OFFICE OF THE COMMISSIONER OF BANKING

SURVEY OF FIRST LIEN REAL ESTATE LOANS FINANCE CHARGE RATES

State	Current Law	Legislative Proposal
Ala.	No Maximum Rate (Loans over $5000)	
Alaska	Fed. Discount Rate plus 5% Loans over $100,000 - No Maximum Rate	
Ariz.	No Maximum Rate 45% criminal usury penalty	
Ark.	10% per yr. (Constitutional limit)	
Calif.	Fixed rate - No Maximum Rate VRM's - Maximum variance of ½% per 6 mos. and 2½% over life of loan	
Colo.	45% per yr. Overrode federal preemption as of 7/1/81	
Conn.	No Maximum Rate	
Del.	No Maximum Rate as of 6/1/81	
Florida	18% per yr.	
Ga.	16.25% per yr. (July '81) indexed	
Hawaii	No Maximum Rate	
Idaho	13% per yr.	
Ill.	No Maximum Rate (Sunset 12/31/81) Former rate- 2½% above monthly index of long term U.S. Government bond yields.	No Maximum Rate
Ind	No Maximum Rate (4/21/81)	

[illegible] Real Estate Loans 2

State	Current Law	Legislative Proposal
Iowa	No Maximum Rate overrode federal preemption [illegible]	
Kansas	[illegible] [illegible] overrode federal preemption	
Ky.	No Maximum Rate - Loans over $[illegible] Fed. Discount Rate plus 4 percent not to exceed [illegible]% per yr. - Loans under $[illegible]	
La.	[illegible]% per yr.	
Maine	No Maximum Rate overrode federal preemption effective Sept. [illegible]	
Md.	No Maximum Rate	
Mass.	No Maximum Rate overrode federal preemption	
Mich.	25% per yr.	
Minn.	No Maximum Rate (Sunset 8/1/85) overrode federal preemption	
Miss.	10% per yr.	
Mo.	16% per yr. plus 1 point (7/1/81)	
Mont.	No Maximum Rate (Sunset 7/1/83)	
Neb.	No Maximum Rate - Loans over $25,000	
Nev.	No Maximum Rate overrode federal preemption 7/1/81	
N.H.	No Maximum Rate	

First Lien Real Estate Loans 3

State	Current Law	Legislative Proposal
N.J.	14.5% per yr. but not to exceed 8 points over long term U.S. Government bond rate.	
N.M.	No Maximum Rate (Sunset 6/30/83) overrode federal preemption	
N.Y.	25% per yr.	
N.C.	No Maximum Rate	
N.D.	No Maximum Rate overrode federal preemption 7/1/81	
Ohio	Federal Discount Rate plus 3% $10 per $100 per yr. (banks)	
Okla.	18% per yr.	
Ore.	12% per yr. No Maximum Rate - Loans over $50,000	
Pa.	Long Term U.S. Government bond rate plus 2½% (15.5% - July '81)	
R.I.	21% per yr.	
S.C.	No Maximum Rate	
S.D.	No Maximum Rate overrode federal preemption 3/19/80	
Tenn.	FNMA monthly auction rate plus 2%, not to exceed 18%	
Tex.	10 yr. T-note rate plus 2% but not less than 10% per yr. or more than 12% per yr.	

First Lien Real Estate Loans 4

State	Current Law	Legislative Proposal
Utah	18% per yr. by statute or Commissioner can set rate as high as 2 yr. government securities average yield plus 10%.	
Vt.	No Maximum Rate	
Va.	No Maximum Rate	
Wash.	Average yield for 26 wk. T-bills plus 4% (19.58% - June '81)	
W. Va.	Average yield of 20 and 30 yr. long term government bonds plus 1½% (15.25% - July '81)	
Wis.	No Maximum Rate	No Maximum Rate
Wyo.	No Maximum Rate	

SURVEY OF CLOSED END CONSUMER CREDIT FINANCE CHARGE RATES

State	Current Rate	Legislative Proposals
Ala.	$15 per $100 per yr. to $750, $10 per $100 per yr. from $751 to $2000. $8 per $100 per yr. from $2001 to $5000. Over $5000 - No Limit $2000/24 mos. - 21.25% APR	
Alaska	10% per yr. to $1000, (retail) 8% per yr. over $1000 $2000/24 mos. = 16.42% APR	
Ariz.	No maximum rate 45% per yr. criminal usury rate	
Ark.	10% per yr. constitutional limit	Amendment to repeal will be on 1933 ballot
Calif.	No maximum rate (banks) $11 per $100 per yr. to $1000, (retail) $8 per $100 per yr. over $1000 $2000/24 mos. = 17.29% APR	
Colo.	36% per yr. to $630, (banks) 21% per yr. from $631 to $2100, 15% from $2101 or 21% on all unpaid balances, which is greater. $2000/24 mos. = 22.95% APR 25% per yr. to $630, (retail) 20% per yr. from $631 to $2100, 15% per yr. from $2101, or 18% per yr. whichever is greater. $2000/24 mos. = 19.80% APR	
Conn.	18% per yr. (banks and thrifts exempt)	21% per yr.
Del.	No Maximum Rate	
Fla.	$12 per $100 per yr. $2000/24 mos. = 21.5% APR	

Closed End Consumer Credit 2

State	Current Rate	Legislative Proposal
Ga.	$13 per $100 per yr. (retail) $2000/24 mos. = 23.25% APR $9 per $100 per yr. (banks) $2000/24 = 16.5% APR	
Hawaii	14% per yr. for 18 mos., 10.5% per yr. for next 12 mos., 7% per yr. for next 12 mos., 4% per yr. for next 6 mos. $2000/24 mos. = 31.13% APR	
Idaho	35% per yr. to $660, (banks) 21% per yr. from $661 to $2200, 15% per yr. from $2201, or 21% on all unpaid balances, whichever is greater. $2000/24 mos. = 28.43% APR (retail) Same as rate for finance companies.	
Ill.	$16 per $100 per yr. to $500 (retail) $14 per $100 per yr. from $501 to $800 $12 per $100 per yr. from $801 $2000/24 mos. = 23.75% APR	No Limit (Passed Legislature)
	$9 per $100 per yr. (banks) $2000/24 mos. = 16.5% APR	No Limit (Passed Legislature)
Ind.	36% per yr. to $540, 21% per yr. from $541 to $1800, 15% per yr. from $1801, or 18% on all unpaid balances, whichever is greater. $2000/24 mos. = 27.15% APR	21% on all unpaid balances, (7/1/81) whichever is greater
Iowa	21% per yr.	
Kansas	21% per yr. to $300, 18% per yr. from $301 to $1000, 14.4% per yr. from $1001, or 18% per yr. whichever is greater. $2000/24 mos. = 17.73% APR	
Ky.	$8 per $100 per yr. (banks) Service fee: $1 per $50 up to $16 maximum $2000/24 mos. = 18.02% APR No Maximum Rate (retail)	

State	Current Rate	Legislative Proposal
La.	24% per yr. to $1750, (retail) 18% per yr. from $1751 to $5000, 12% per yr. from $5001, or 19% on all unpaid balances, whichever is greater. $2000/24 mos. = 27% APR 36% per yr. to $1400, (banks) 27% per yr. from $1401 to $4000, 24% per yr. from $4001 to $7000, 21% per yr. over $7000. $2000/24 mos. = 34.84% APR	
Maine	30% per yr. on bal. to $540, 21% per yr. on bal. from $541 to $1800, 15% per yr. on bal. from $1800, or 18% per yr. on all bal., whichever is greater However, if rate is over 18% for a period of over 36 mos the rate is reduced to 8%. $2000/24 mos. = 24.67% APR	
Md.	22% per yr. to $1000 18% per yr. on bal. over $1000	
Mass.	$12 per $100 per yr. on entire balance (retail) $2000/24 mos. = 21.57% APR Loans to $6000 (banks) 23% per yr. plus $20 service fee Loans over $6000 No limit	
Mich.	$12 per $100 per yr. on 1st $500 (retail) $10 per $100 per yr. from $501 $2000/24 mos. = 19.01% APR 12.83% per yr. (banks)	
Minn.	No Limit (retail) 4½% above fed. discount rate (banks) (excluding surcharge) or 12% per yr , whichever is greater	
Miss	5% in excess of the Federal Reserve Discount Rate (19% per yr., 7/1/81)	

Closed End Consumer Credit 4

Rate	Current Rate	Legislative Proposal
Mo.	26.6% per yr. to $750, (retail) 21.5% per yr. from $751 to $1000, 18% per yr. from $1001 to $7500, No limit from $7501. $2000/24 mos. = 21.75% 26.6% per yr. to $800, (banks) 15% per yr. from $801 to $2500, 10% per yr. from $2501, plus 5% or $15, whichever is less	
Mont.	No Maximum Rate (Sunset 7/1/83)	
Neb.	18% per yr. (retail) 19% per yr. (banks)	
Nev.	No maximum rate (6/26/81)	
N.H.	No maximum rate (3/31/81)	
N.J.	No maximum rate (3/31/81)	
N M.	No maximum rate (7/1/81)	
N.Y.	No maximum rate 25% criminal usury rate	
N.C.	24% per yr. to $1500, (retail) 22% per yr. from $1501 to $2000, 20% per yr. from $2001 to $3000, 18% per yr. from $3001. 16% or the 6 month T-bill rate (banks) plus 6% whichever is greater.	
N.D.	No maximum rate (7/1/81)	

State	Current Rate	Legislative Proposal
Ohio	Below $700 (retail) $8 per $100 per yr. plus service chg. of 50¢ per mo. on 1st $50 + $25 per mo. on next 5 $50 units. Above $500 (retail) 18% per yr. $10 per $100 per yr. (banks) $2000/24 mos. = 22 42% APR	No maximum rate
Okla.	30% per yr. to $540, 21% per yr. from $541 to $1800, 15% per yr. from $1801, or 18% on all balances, whichever is greater.	21%, whichever is treater. (Approx. October, 1981)
Ore.	No maximum rate (retail) Same as finance companies (banks) Most favored lender under state law. $2000/24 mos. = 26.84% APR	No maximum rate
Pa.	Federal Discount Rate plus 5%	The current state rate plus 80% of the 3 month average of the 3 yr. T-bill rate.
R.I.	21% per yr.	
S.C.	36% per yr. to $390, 21% per yr. from $391 to $1300, 15% per yr. from $1301, or 18% on all unpaid balances, whichever is greater. $2000/24 mos. = 24.76% APR	
S.D.	$12 per $100 per yr. (retail) $2000/24 mos. = 21.57% APR No maximum rate (banks)	
Tenn.	$10 per $100 per yr. to $500, (retail)--APR= $8 per $100 per yr. from $501 to $5000, $6 per $100 per yr. from $5001. $2000/24 mos. = 15.55% APR	(banks) 11.58%, loans from 6-12 mos. 12.59%, loans from 13-24 mos. 13 38%, loans from 25-36 mos. 14.17%, loans from 37-48 mos. 15.04%, loans from 49-60 mos.
Tex.	(6 month T-bill rate) X 2, but not less than 18% or greater than 24% per yr.	Service fee: 4% or $25, whichever is less.

State	Current Rate	Legislative Proposal
Utah	36% per yr. to $660, 21% per yr. from $661 to $2200, 15% per yr. from $2201, or 18% on all unpaid balances, whichever is greater. $2000/24 mos. = 28.43% APR	
Vt.	18% on 1st $500 15% on balance over $500	
Va.	24% per yr. (retail) No maximum rate (banks) Service fee: 2% of loan.	
Wash.	26 week T-bill (previous month) (banks) plus 4% 26 week T-bill (previous month) (retail) plus 6%	
W Va	18% per yr. Reasonable service fee	
Wis	18% per yr. on 1st $1000, 15% per yr. on bal over $1000	18% per yr. or 6% above the 6 month T-bill rate, whichever is greater
Wyo	36% per yr. to $300, 21% per yr. from $301 to $1000, 15% per yr. from $1001, or 21% on all unpaid balances, whichever is greater. $2000/24 mos. = 22.95% APR	

The rates disclosed are the same for closed end credit extended by retailers and by banks unless otherwise noted.

For purposes of comparison this charge discloses the APR for an amount financed of $2,000 for a term of 24 months for those states with split rates.

The rates disclosed under the heading "Legislative Proposal" for Indiana, Oklahoma and Tennesse are currently in effect or become effective on the date indicated.

SURVEY OF OPEN END CONSUMER CREDIT FINANCE CHARGE RATES

State	Current Rate	Legislative Proposal
Ala.	21% per yr. on 1st $950. 18% per yr. on remaining balance.	
Alaska	18% per yr. on 1st $1,000. 8% per yr. on remaining balance. $1.00 min. finance chg.	
Ariz.	No maximum rate 45% criminal usury limit	
Ark.	10% per yr. constitutional limit	Amendment to repeal will be on 1983 ballot
Calif	No maximum rate (bank card) 19.2% per yr. (retail)	
Colo.	21% per yr. 50¢ min. finance chg.	
Conn.	15% per yr. No limit on membership fee, over limit chg. & del. chg.	18% per yr.
Del.	No Maximum Rate	
Fla.	18% per yr. (retail) $1.00 min. finance chg. 18% per yr. (bank card)	
Ga.	21% per yr. (retail) $1.00 min. finance chg. 18% per yr. (bank card) $12.00 membership fee Default chg. - greater of $1.00 or 5% up to $5.00	
Hawaii	24% per yr.	

State	Current Rate	Legislative Proposal
Idaho	21% per yr. 50¢ min. finance chg.	
Ill.	21.6% per yr. (retail) 70¢ min. finance chg.	No maximum rate (Passed Legislature)
	18% per yr. (bank card) 25¢ transaction chg. or $20.00 annual fee	No maximum rate (Passed Legislature)
Ind.	18% per yr. 50¢ min. finance chg.	
Iowa	18% per yr. on 1st $500, 15% per yr. on remaining balance. 50¢ min. finance chg.	
Kansas	Same as closed end credit rate 50¢ min. finance chg.	
Ky.	18% per yr. (bank card)	
	No maximum rate (retail)	
La.	18% per yr. Membership fee: $12.00 (banks)	21% per yr.
Maine	18% per yr. 50¢ min. finance chg. (retail only)	
Md.	22% per yr. on 1st $1,000 (retail) 18% per yr. on remaining balance	
	18% per yr. on 1st $700, (banks) 12% per yr. on remaining balance.	
Mass.	18% per yr. on 1st $500, 12% per yr. on remaining balance. 50¢ min. finance chg.	18% on entire balance
Mich.	20.4% per yr. (retail) 70¢ min. finance chg.	Legislative Subcommittee discussing elimination of rate ceilings.
	18% per yr. (banks)	

State	Current Rate	Legislative Proposal
Minn.	16% per. yr. (retail) 50¢ min. finance chg. 18% per yr. or (bank card) 12% per yr. and a $15 annual fee	18% per yr. for retailers with sales under $25 million annually. (Aug. 81)
Miss.	21% per yr. 50¢ min. finance chg.	After 7/1/82 18% per yr. on 1st $800 15% per yr. from $801 to $1200 12% per yr. on excess over $120[illegible]
Mo.	18% per yr. (retail) 70¢ min. finance chg. 22% per yr. on 1st $1000 (bank card) 10% per yr. on remaining balance	
Mont.	18% per yr. (retail) 50¢ min. finance chg. No Maximum Rate (bank card)	
Neb.	21% per yr. on 1st $500 18% per yr. on remaining balance	
Nev.	No maximum rate (6/26/81)	
N.H.	No maximum rate	
N.J.	No maximum rate (3/31/81)	
N.M.	No maximum rate (7/1/81)	
N.Y.	No maximum rate 25% criminal usury rate	
N.C.	18% per yr.	21% per yr.
N.D.	No maximum rate (7/1/81)	
Ohio	18% per yr. $1 min. finance chg.	No Maximum Rate

Open End Consumer Credit 4

State	Current Rate	Legislative Proposal
Okla.	18% per yr. (retail) 50¢ min. finance chg. Same as closed end credit rate (bank card)	
Ore.	No maximum rate (retail) Same as finance company rate (bank card) Most favored lender under state law.	No maximum rate
Pa.	15% per yr. 70¢ min. finance chg.	See closed end credit rates
R.I.	18% per yr. (retail) 50¢ min. finance chg. 21% per yr. (bank card)	
S.C	24% per yr. to $650 18% per yr. on remaining balance Membership fees permitted	
S.D.	20% per yr. (retail) 50¢ min. finance chg. 24% per yr. on 1st $500 (bank card) 18% per yr. on remaining balance $1 min. finance chg.	
Tenn.	18% per yr. 70¢ min. finance chg.	
Tex.	Same as closed end credit	
Utah	No maximum rate (retail) 18% per yr. (bank card) 50¢ min. finance chg.	
Vt.	18% per yr. on 1st $500 15% per yr. on remaining balance 50¢ min. finance chg. (retail only)	

Open End Consumer Credit 5

State	Current Rate	Legislative Proposal
Va.	18% per yr.	
Wash.	18% per yr. $1 min. finance chg.	
W. Va.	18% per yr.	
Wis.	18% per yr. on 1st $1000 15% per yr. on remaining balance	18% per yr. on entire balance or 24% per yr. if 2 yr. T-note rate exceeds 14.5% for 4 wks.
Wyo.	21% per yr. 50¢ min. finance chg.	

The rate disclosed is the same for retail revolving charge plans and bank credit card plans unless otherwise noted.

SURVEY OF FINANCE COMPANY CONSUMER CREDIT FINANCE CHARGE RATES

State	Current Law	Legislative Proposal
Ala.	Loans under $750 36% per yr. to $200 24% per yr. from $201 to $749 Loans over $750 - Same as closed end credit $2500/36 mos. = 19.75% APR	
Alaska	36% per yr. to $500. 24% per yr. from $501 to $1000. 12% per yr. from $1001 to $5000. $2500/36 mos. = 23.07% APR	
Ariz.	Loans to $1000 36% per yr. on 1st $300, 24% per yr. from $301 to $600, 18% per yr. from $601 to $1000. Loans over $1000 30% per yr. on 1st $300, 24% per yr. from $301 to $1000 18% per yr. from $1001 to $1500, 12% per yr. from $1501 to $10,000 $2500/36 mos. = 21.429% APR	
Ark.	10% Constitutional Limit	Amendment to repeal will be on 1983 ballot
Calif.	30% per yr. to $225, 24% per yr. from $226 to $900, 18% per yr. from $901 to $1650, 12% per yr. from $1651 to $10,000, or 19% per yr., whichever is greater. $2500/36 mos. = 21.44% APR	
Colo.	36% per yr. to $630, 21% per yr from $631 to $2100, 15% per yr. from $2101 or 21% per yr. $2500/36 mos. = 21.39% APR	
Conn.	$17 per $100 per yr. to $600, $11 per $100 per yr. from $601 to $5000 $2500/36 mos. = 21.25% APR $11 per $100 per yr. over $1800 (secured by real estate)	

Finance Company Consumer Credit 2

State	Current Law	Legislative Proposal
Del.	No Limit	
Fla.	30% per yr. to $500, 24% per yr.. from $501 to $1000, 18% per yr. from $1001, or 18% per yr. on loans over $2500.	
Ga.	Loans to 36 months $10 per $100 per yr. (discount) Service fee: $48 on 1st $600; 4% on excess plus $2 per month $25000/36 mos. = 22.25% APR	
Hawaii	Same as closed end credit rate $2500/36 mos. = 30.51% APR	
Idaho	36% per yr. to $660, 24% per yr. from $661 to $2200, 18% per yr. from $2201, or 21%, whichever is greater.	
Ill.	Loans to $3000 30% per yr. to $300, 24% per yr. from $301 to $600, 18% per yr. from $601 to $3000 $2500/36 mos. = 21.35% APR	No maximum rate (Passed Legislature)
	Loans over $3000 24% per yr. on loans to 24 mos. 19 39% per yr. on loans to 30 mos. 19.57% per yr. on loans to 36 mos.	No maximum rate (Passed Legislature)
Ind.	Same as closed end credit rate $2500/36 mos. = 25.28% APR	
Iowa	Loans to $2000 36% per yr. on 1st $500, 24% per yr. from $501 to $1200, 18% per yr. from $1201 to $2000,	
	Loans over $2000 $10 per $100 per yr. (discount) Service fee: $1 per $50 (2%) $2500/36 mos. = 26.05% APR	

Finance Company Consumer Credit - 3

State	Current Law	Legislative Proposal
Kansas	36% per yr. to $420 21% per yr. from $421 to $1400 14.45% per yr. from $1401 to $25,000 or 18% per yr., whichever is greater $2500/36 mos. = 21.35% APR	
Ky	Loans to $2000 36% per yr. on 1st $500 24% per yr. from $501 to $1500 18% per yr. from $1501 to $2000 Loans over $2000 9% per $100 per yr. Service fee: 1% per $50 up to $40 maximum $2500/36 mos. = 15.94% APR	
La	Same as closed end rate for banks $2500/36 mos. = 21.58% APR	
Maine	Same as closed end rate $2500/36 mos. = 21.33% APR	
Md	Loans to $2000 33% per yr. to $500 24% per yr. from $501 to $700 15% per yr. from $701 to $2000 Loans from $2001 to $3500 21% per yr. Loans from $3501 to $5000 18% per yr. Loans over $5000 16.2% per yr.	
Mass.	Same as closed end bank loan rate	
Mich.	Loans to $3000 31% per yr. to $500 13% per yr from $501 to $3000 or 18% per yr., whichever is greater $2500/36 mos. = 18.74% APR Loans over $3000 (7% per yr.)	

Finance Company Consumer Credit 4

State	Current Law	Legislative Proposal
Minn.	Loans to $1200 33% per yr. to $300 19% per yr. from $301 to $600 15% per yr from $601 to $1200 Service fee: $1 per $100 Loans over $1200 $9 per $100 per yr. to 36 mos. (discount) $8.37 per $100 per yr. to 48 mos. $7 75 per $100 per yr. to 60 mos. Service fee: $1 per $50 to $40 maximum $2500/36 mos. = 22.90% APR	33% per yr. to $350 (8/1/81) 19% per yr. from $351 to $35,000 or 21.75% per yr., whichever is greater
Miss.	35% per yr. to $800 plus the amount by which the Fed. Discount Rate exceeds 9% (41%) 33% per yr. from $801 to $1800 plus the amount by which the Fed. Discount Rate exceeds 10% (37%) 24% per yr. from $1801 to $4500 plus the amount by which the Fed. Discount Rate exceeds 10% (28%) 12% per yr. from $4501 plus the amount by which the Fed. Discount Rate exceeds 10% (16%) $2500/36 mos. = 37.61% APR	
Mo.	Same as closed end credit for banks $2500/36 mos. = 20.5% APR	
Mont.	$20 per $100 per yr. to $300, $16 per $100 per yr. from $301 to $500, $12 per $100 per yr. from $501 to $1,000, $10 per $100 per yr. from $1,001 to $7,500. $2500/36 mos. = 21.33% APR	$20 per $100 per yr. to $500, $16 per $100 per yr. from $501 to $1,000, $12 per $100 per yr. from $1001 to $7,500. Loans over $7,500 - 2% per mth. (10/1/81)
Neb.	24% per yr. to $1000, 18% per yr. from $1001 to $5000 16% per yr. from $5001 to $7000 $2500/36 mos. = 21.47% APR	
Nev.	No maximum rate (6/26/81)	
N.H.	Loans to $1500 24% per yr. to $600 18% per yr. from $601 to $1500 Loans over $1500 - No maximum rate	
N.J.	No maximum rate (3/31/81)	

State	Current Law	Legislative Proposal
N.M.	No maximum rate (7/1/81)	
N.Y.	No maximum rate 25% criminal usury rate	
N.C.	Loans to $3000 36% per yr. to $600, 18% per yr. from $601 to $3000 Loans above $3000 Same as closed end credit bank rate $2500/36 mos 24.57% APR	
N.D.	No maximum rate (7/1/81)	
Ohio	Loans to $3000 $16 per $100 per yr. to $750, $11 per $100 per yr. from $751 to $1500 $9 per $100 per yr. from $1501 to $3000 Loans over $3000 18% per yr.	As of 7/14/81 Loans to $1000 - 28% APR Loans from $1000-$5000-22% APR
Okla.	Same as closed end credit rate	
Ore.	Loans to $5000 36% per yr. to $500, 21% per yr. from $501 to $2000, 15% per yr. from $2001 to $5000 $2500/36 mos. = 25.23% APR Loans over $5000 19% per yr.	No maximum rate
Pa.	$9.50 per $100 per yr. 1st 36 mos. (discount) $6.00 per $100 per yr. for next 24 mos., plus 6% per yr. on balances over $5000 or for term over 60 mos. Service fee: $15 maximum $2500/36 mos. = 23.71% APR	
R.I.	Loans to $2500 36% per yr. on loans to $300, 30% per yr. on loans from $301 to $800, 24% per yr. on loans from $801 to $2500. (This is not a step rate schedule) Loans over $2500 21% per yr.	

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State	Current Law	Legislative Proposal
S.C.	Same as closed end credit rates $2500/36 mos. = 22.98% APR	
S.D.	Loans to $2500 30% per yr. to $500, 24% per yr. from $501 to $1200, 18% per yr. from $1201 to $2000, 12% per yr from $2001 to $2500 $2500/36 mos. = 23.52% APR Loans over $2500 19.5% per yr.	
Tenn.	$7½ per $100 per yr. (discount) Service fee: $7.50 Monthly fee: $1.00 $2500/36 mos = 22% APR	
Tex.	Same as closed end credit rate	
Utah	Same as closed end credit rate $2500/36 mos. = 26.75% APR	
Vt.	Loans to $3000 24% per yr. to $1000 12% per yr. from $1001 to $3000, or 18% per yr. whichever is greater. $2500/36 mos. = 19.06% APR	
Va.	Loans to $2500 36% per yr. to $500 30% per yr. from $501 to $1500, 18% per yr. from $1501 to $2500 $2500/36 mos. = 28.15% APR (Est.)	
Wash.	Loans to $2500 30% per yr. to $500 18% per yr. from $501 to $1000, 12% per yr. from $1001 to $2500. $2500/36 mos. = 19.35% APR Loans over $2500 $10 per $100 per yr. (discount) Service fee: 2% of loan amt. Monthly Fee: 50¢	

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State	Current Law	Legislative Proposal
W. Va.	Loans to $1600 36% per yr. to $500, 24% per yr from $501 to $1500, 18% per yr. from $1501 to $1600 Loans over $1600 21% per yr. on 1st $5000, 18% per yr from $5000	
Wis.	Loans to $3000 $9.50 per $100 per yr. to $2000 (discount) $8.00 per $100 per yr. from $2001 to $3000 Loans over $3000 19% per yr.	Loans to $3000 23% per yr., or Loans above $3000 20% per yr., or 6% above the 2 yr. T-note, whichever is greater.
Wyo.	Same as closed end credit $2500/36 mos. = 21.39% APR	

For purposes of comparison the chart discloses the APR for an amount financed of $2500 for a term of 36 months for those states with split rates.

The rates disclosed under the heading "Legislative Proposal" for Minnesota, Montana and Ohio are currently in effect or become effective on the date indicated.

Mr. Boyle. I believe there are 44 States.

Senator Proxmire. You say 44 States do have one kind of usury statute or another and 6 do not?

Mr. Boyle. That's correct.

Senator Proxmire. Can you give me some notion—and I don't want a long answer, but can you give me some notion of how restrictive those statutes are? In many cases they just restrict one kind of credit?

Mr. Boyle. There are a few in that category. Most are broken up into various kinds of loans. They have different ceilings for different kinds of lending.

Senator Proxmire. How many States have usury statutes that limit the interest to 10 percent or less?

Mr. Boyle. Just Arkansas.

Senator Proxmire. Only Arkansas?

Mr. Boyle. That's correct.

Senator Proxmire. How about 18 percent or less?

Mr. Boyle. I think we have a table attached to our testimony which lays out the rates for automobile loans—well, as of 1979. There have been some changes since then, but that's the most recent—revolving credit, automobile loans and loans of $2,500. There have probably been 10 States that have maintained it—maybe a few more than that, but that gives you a rough idea.

Senator Proxmire. Well, now, as I say, I do have respect for all of you and I do my best to try to support consumer positions

because I think they are most enlightened and, by and large, you don't have a special interest of the usual kind that you're pushing. You're for the public interest in the broadest sense. But I must say, to me, a usury statute has about as much effect on the interest rates that people pay as a law that we might pass saying the humidity can never go above a certain percentage or the temperature can't go above 90 degrees.

Senator TOWER. Let's try that anyway.

Senator PROXMIRE. Especially for Texas that might be useful.

But after all, if you had an inflation rate of 12-percent, no lender in his right mind, if he anticipates the 12-percent inflation rate, is going to lend money at 10 percent. Why should he? He can take that same money and invest it in commodities or real estate or whatever and diversify rather than lend it to somebody else to make money on his investment.

Mr. BOYLE. Senator, by and large, in the last 2 years, all States have looked at this problem. They have all reacted one way or another. All these arguments that you're making on the cost of money were made before each of the State legislatures. Some accepted and changed their rates. A few States deregulated entirely. They all considered the economic factors like the number of loan companies in the State or the number of automobile dealers in the State and how they are doing. Michigan just extended its 16 percent ceiling. It used to be 12 and they extended it to 16 and they considered it in a State that's very sensitive to that particular question. So we have all of these States considering it.

Let me just make one further comment. That is, these things are not that simple. They are more complicated. They are a mix. For example, when you look at finance companies, the rates are often set with a combination of looking at things like the credit life insurance, the accident and health, and the profits that are made. It's a combination. You're reaching penetration rates of finance companies in some States of 80 or 90 percent. You're looking at a total package.

What happens when you just issue one thing from Washington is there's a balance that many of these States have struck here between——

Senator PROXMIRE. I was just going to say the reason why we are concerned about this is that we have fine Senators—you mentioned Arkansas, Mr. Schechter. We have Senator Bumpers and Senator Pryor, who have been here on bended knees asking for relief. They are saying, "Our business is in terrible shape. The only way that our people can get loans is to go outside the State to get them." And these are Senators who really represent their people very well. They are back there all the time. They are talking to their people at all levels. They are talking to consumers, bankers, and others, and they certainly have my respect, and I don't see how anybody could represent a State any better than those two Senators do.

Why don't they know what they're talking about?

Mr. SCHECHTER. Senator Proxmire, let me point out that we have had at least one member of the congressional delegation from Arkansas that has changed his mind. According to the Arkansas Gazette last week, Mr. Bethune said he will no longer support

moves to repeal the constitutional provision; he will listen to the voice of the people. Those are the words he used, not mine. I'm just repeating them.

I think there is not a complete cessation of lending by a long shot in Arkansas. The banks must have money to meet everyday demands and, of course, as you know, they lend it out. They have no ceiling now on business and mortgage loans, but they have had that ceiling for over 100 years and they have managed even during periods of when rates were much higher and the banks, even in those periods, came up with a profit.

Senator PROXMIRE. Well, Senators Bumpers and Pryor would come in and say that they'd go back and be hit over and over again, not just by bankers, but by farmers and by businessmen, saying, "We're desperate. You have to help us. We simply can't get the kind of credit we need because the bankers can't afford to lend it to us."

Mr. SCHECHTER. It may be that bankers can't make 10 percent consumer loans, but if you would take a look at the ads appended to my statement you will see local merchants and national merchants offering easy credit, and some people have said, "Well, they make it up in the prices." I don't think that is so because the national chains actually set their prices regionally.

Senator PROXMIRE. Why isn't the real answer to this—after all, we have 30,000 credit institutions of one kind or another—credit unions, banks, savings and loans—more than any other country by far, very diversified and highly competitive. Why isn't the answer, No. 1, competition; and, No. 2, disclosure? We have a Truth-in-Lending Act. Maybe it's not as effective as it ought to be and we're going to try to make it more effective. But if people know and are told what the true annual rate is if they go to any credit institution and get a loan, why shouldn't that be the answer?

MONEY SUPPLY KEPT WITHIN CERTAIN BOUND

Mr. SCHECHTER. The answer there is the money capital markets are not completely freely competitive. We know the Federal Reserve has a tremendous influence on what the interest rates are and when money is tight and interest rates are high it is not a matter of competition just among lenders. It's a matter of a supply being kept within a certain bound. Therefore, the sellers can charge what the market will bear and the people who can pay most are the ones who can obtain the credit and in the bidding rates get ratcheted up higher and higher and the people suffer.

Look at what's happening to bankruptcies in this period. I'm not talking about just individual bankruptcies. I'm talking about business bankruptcies. In the data available for 1981 for 1 or 2 months, it shows a continuation of the acceleration of business bankruptcies at very significant levels.

Senator PROXMIRE. There are all kinds of reasons for that. I'm not sure the usury statute would be the answer.

Let me ask Ms. Broadman this. The credit unions favor this legislation. They say when market interest rates rise above ceilings, the supply of credit diminishes and low income borrowers are unable to obtain loans from lenders. The credit unions seem to

completely contradict your point that usury limits protect low income borrowers.

On the contrary, credit would appear to dry up for riskier, low income borrowers. What's your comment on that?

Ms. BROADMAN. My comment on that is that usury ceilings that are set at reasonable levels do not dry up credit and that they do serve to protect low-income borrowers from being charged excessive interest rates.

If you look at some of the examples that CFA has pulled together and when you look at some of the examples that were presented in hearings at which the D.C. government decided to adopt its auto usury limit, you will find that people were being charged eggregiously high interest rates, way out of line with the market. Usury ceilings keep low-income people, who are captive borrowers, from being gouged. That is why we support usury ceilings that are set at reasonable levels.

The States are very sensitive to some of the concerns you have raised—especially the fact that if the interest rate ceiling is very low, credit will dry up. The States are moving. They are getting rid of low ceilings. They are experimenting with different kinds of ceilings. As Senator Dodd mentioned in his opening statement, some States are indexing their ceilings a certain number of percentage points above the Treasury bill indexes. Other States are trying other alternatives. There's a lot of experimentation by the States which are setting usury ceilings at reasonable levels.

It would be a shame for the Federal Government, because of what is happening in a single State, to wipe out, in one piece of legislation, all these State laws that are serving a legitimate function, including not only the usury ceiling but all State laws that prohibit unconscionable credit laws as well.

Senator PROXMIRE. My time is up.

Senator TOWER. Let me ask all of the committee members to be diligent in their observation of the time limitation. We do have two more panels and seven more witnesses. Senator Lugar.

Senator LUGAR. Thank you, Mr. Chairman.

A study that was completed by Purdue University on the impact of the 10-percent usury ceiling in Arkansas came to these conclusions. One of the most interesting findings was that commercial banks evidently altered their pricing policies in response to restrictive loan rate ceilings.

Second, the study concluded that the 10-percent Arkansas rate ceiling eliminated conventional cash creditors who serve high risk customers and allowed pawnshops to proliferate.

The third caused customers in general and high risk customers in particular to change their credit sources from cash credit to dealer originated credit.

The point of reciting these conclusions of the Arkansas study is simply to try to address the consumer interests of this legislation. Obviously, there are many interests that have been touched upon by other testimony as far as the drying up of automobile sales in the country, the problems of savings and loans and others that are in difficulty, given the restrictions on the amount of money they are able to charge, given the amount of money they are paying for money. But it would appear that even in the Arkansas situation

where the case for the usury ceiling has been argued, in fact lending institutions, by rearranging the structure of credit, may be able to obtain a return that is more satisfying and thus the 10 percent ceiling may stand as a psychological and satisfying barrier, but in fact, as the study points out, moving from conventional sources to pawnshops is maybe not in the consumer's interest, or maybe finally consumers are getting the money they're paying for it and ultimately the market works.

Now what is your response to this? Is it essentially that by having ceilings this sort of thing is held to a dull roar and at the margin you sort of ignore the difficulties and the restructuring as people actually search for credit and obtain it? Does anybody have a comment on that?

Mr. SCHECHTER. Senator Lugar, I'm sure there are some evasions of the ceilings which go undetected, but my answer would be take a look at the record of attempts by amendment or referenda to have that ceiling eliminated or amended.

AMENDMENT SOUNDLY DEFEATED

In 1956 there was such an amendment and the votes were 127,000 for the amendment and 291,000 against it. In 1974, the vote totals were 66,900 for such an amendment and 426,000 against it. In 1980, there were two proposals on the ballot. One was a constitutional amendment which would have thrown it wide open and leave it to the legislature. The people defeated the constitutional amendment and that was a major issue dealing with the 10-percent ceiling, with 63 percent voting against the new constitution. There was also a separate amendment which would have set a higher ceiling on the rate and that was defeated 56 percent to 44 percent.

The people of Arkansas have apparently found that it is satisfactory. They don't feel that a 10-percent ceiling hurts them. They feel that it benefits them.

Senator LUGAR. Does anybody else have a comment on the Arkansas problem?

Mr. BOYLE. Our comments—you referred to a study that was the same study basically showing that credit availability in Arkansas is as good as many States that have high interest rate ceilings, but I think when you're talking about restructuring, it would have been nice if Purdue would have taken a look possibly at other States to see what kind of restructuring is going on.

My understanding is, for example, in automobile credit, there has been substantial restructuring basically to GMAC and Ford Credit Co. away from bank credit in automobile lending. I noticed in this morning's Washington Post that money is available at low prime rates by finance companies. I think we are seeing restructuring here regardless of the ceilings or whether the States are deregulated or not. So I'm not sure the ceilings have caused that kind of dislocation.

Senator LUGAR. I think what we discovered last week in the hearings is perhaps the citizens of Arkansas are the beneficiaries in a sense and that the automobile dealers must subsidize car purchases in Arkansas and they must extract more out of the hides in other States. So there's a rather unusual situation going on here.

I would guess if you were clever enough to keep usury rates on in your State, perhaps you might extract gold from others, which is one reason we're in this problem. We have a national economy and credit flowing in a fungible way.

Mr. BOYLE. Cars are sold by dealers at the retail level. Usually there's quite a lot of room between the dealer's cost and the retail cost.

Senator LUGAR. In fact, we were told you could not finance a car in Arkansas. Essentially, all the credit comes through the dealer organizations, so that, in essence, it doesn't make any difference what the margin was at the dealer's level at that point. The car dealers themselves from Arkansas, of course, were in here testifying that we need to get rid of the usury ceiling and a large part is because they are not selling many cars.

Mr. BOYLE. I would like to put one thing in the record. That is, we have looked at two recent brokerage houses surveys of automobile sales in the future and they are basically saying that when you reach 16, 17, and 18 percent you're reaching a barrier. Even though the income in relationship to these monthly payments has increased, you reach that barrier. And the interest rate, when you reach that level, is just a level which is cutting off the sales. So that the fact that you take the ceilings off doesn't mean you're going to increase sales one iota.

Senator LUGAR. It would have an inhibiting effect, no doubt. I think we're trying, however, desperately to see if there are not some things we can do in our national economy that would assist.

Let me just cite the New York State Banking Study, often commented on in these hearings, by Commissioner Siebert; and the conclusion she reached is that there has been an increase in the availability of consumer credit in New York. This is as a result of the deregulation. The number of financial institutions which had previously placed limits on consumer lending have actually reentered the market, liberalized their credit standards, and raised their credit line limits. There was also some indication that automobile dealers had increased availability to finance with the average consumer.

Now her conclusions are not a widesweeping endorsement of the legislation, but they are a comment on the consumer side of it. Apparently in New York State there's been greater availability of consumer credit from a wider number of sources, apparently much more competitive, less restrictive, which I think is important if one were to argue simply on the consumer grounds on this legislation.

Do you have a comment on that?

Mr. BOYLE. There was a part of that study where the appliance dealers refused to respond to this study. The study was made at a very early time, only a couple months after this legislation went into effect. So I think to really look at the New York situation it would be important to look at it in a longer frame of reference. But even there you saw very, very high, what we typically term loanshark rates, up to 208 percent in appliances, but skyrocketing in appliance sales, I think indicating that the competitive free market role there wasn't working.

Senator LUGAR. Thank you very much.

Senator DODD.

Senator DODD. Thank you, Mr. Chairman. I thank the panel for appearing here this morning.

I would like to follow a bit on one of the questions that Senator Proxmire asked that had to do with the number of States that presently have usury ceilings.

STATES CHANGE USURY CEILINGS

Do you have any idea of how many States in the last several years, say the last 2 or 3 years, have made changes in their existing State structures by legislative action?

Ms. BROADMAN. Since December 1979, 34 States have either lifted or raised their usury ceilings. There are a number of proposals in the States to further raise or eliminate ceilings. There has been a considerable amount of activity in the States on this issue.

Senator DODD. Thirty-four States?

Ms. BROADMAN. At least 34. There may be more, but at last count there were 34.

Senator DODD. And you said there are six that have no ceilings at all?

Ms. BROADMAN. It depends on the type of consumer credit. I have the numbers broken down for finance company loans and real estate loans, et cetera.

Senator DODD. Roughly, anyway, there has been a lot of State activity?

Ms. BROADMAN. Yes.

POSSIBILITY OF INDEXING

Senator DODD. Let me raise a question with you. We had witnesses here last week who compared credit, as an economic commodity, to potatoes. Obviously, I had some problems with that. I assume this panel would as well, as people involved with consumer interests. I wonder if you might comment on the thought of indexing. This has been raised as a possible alternative to just lifting ceilings entirely trying to index the ceilings to some national indicator. I wonder if you might comment on that, again, any one of you or all of you, and if you were to set an index, what would your indicator be? What would you suggest we use as an index?

Mr. SCHECHTER. The usual practice—and this has been done in other countries, with disastrous results—the usual practice is to set an index consisting of an average of interest rates or to move interest rates in accordance with what would be the Federal Reserve discount rate, but what happens there is during a period when rates are going up there's a built-in escalator there. The ratchet effect is built in because when one rate goes up, the other does, and pretty soon the index is going up and again and again it goes up. It formalizes very much really the concept we have now of rates being ratcheted up.

Senator DODD. What about interest rates? Let's use the Fed discount rate as an example. I agree with you that with the Consumer Price Index you have ratcheting, but if you used interest rates——

Mr. SCHECHTER. At a period like this, we have been bidding up interest rates really, with the help of the Federal Reserve tight

monetary policy; but, nevertheless, the interest rates go up and we have countries like Brazil that have tried this sort of thing and other South American countries and we see there that the interest rates go up tremendously and it becomes an engine for inflation. We have had—some of that is being done with adjustable rate mortgages, for example, where there are indexes and the rates are increased.

Now in England, one of the factors, for example, that helped jolt up their inflation rate was about 1 year ago they had to go in for an increase in their rates on adjustable rate mortgages from 11 to 15 percent in one shot. Now that certainly has an effect on the cost of living and, therefore, you've got the whole inflation syndrome stimulated.

So I think the more we go to the indexing, especially of rates which do change frequently, once the upward cycle starts, it would be accelerated.

Senator DODD. You sound like you would be more opposed to that than just lifting the ceiling altogether.

Mr. SCHECHTER. I don't know which is worse, but I would rather—let me for a moment—I heard you speak earlier of the high-interest rates generally being our problem and we can't really separate the consumer interest rates from the rest of that problem. Let me take one example.

When three large oil companies go to banks and get commitments for a total of $13.5 billion in loans because they may want to take over some other company, that in itself, even a commitment, sets up vibes in the financial markets; $13.5 billion is enough to take care of 3 to 6 months of all net increases in consumer credit in the country. So there's bound to be an impact. And if we're talking about the interest rates and what to do about it, we have to start taking a look at the larger users of credit, too.

Senator DODD. Would either of you like to comment on the possibility of indexing?

Ms. BROADMAN. Some of the States have adopted that proposal. Some of them have used the discount rate and others the Treasury bill rate. So we're seeing some experimentation in the States. We should wait and see how that works out. Some of the State banking regulators are concerned about problems indexing creates, depending on how its structured. At this point, the best procedure is to let the States experiment with different kinds of usury ceilings and then evaluate how they work and what kind of impact they have had on the cost of money, on credit availability and so on. Then we can make a informed decision on the Federal level.

Senator DODD. We may not have a great deal of time. We're moving rapidly. Would you want to comment, Mr. Boyle?

Mr. BOYLE. No.

USURY CEILINGS COULD BE NATIONAL PROBLEM

Senator DODD. Senator Lugar has pointed out, and other witnesses last week did as well, that various industries are having tremendous difficulties and they boil it down basically to the fact that the cost of money is going up and they are faced with these usury ceilings. They indicate that it's a national problem.

Granted, this is beginning to sound like the Arkansas relief act, we're spending so much time talking about Arkansas, and I'm certainly sympathetic to my colleagues in the Senate and the House from Arkansas, but I don't think we ought to necessarily take a national legislative step merely to address one State's problem.

So I'm a little uneasy about that approach, but they have suggested and there have been people that have come from across the country suggesting this is a national problem. Ms. Broadman, you suggested in your testimony that Federal legislation ought to be invoked where there is a national need and there is no other recourse—no other apparent recourse. It sounds to me like we've got a national problem here. We had, for instance, last year the FTC rule on funeral homes—the decision on whether or not to regulate funeral homes. I had great difficulty with that notion, whether or not the Federal Government ought to be involved in the regulation of State funeral homes. The argument then by many of the consumer groups was that it was a national issue and we had no other recourse other than national legislation.

How can you answer the question that this is not a national problem we're dealing with, even though Arkansas is the worst case? We do have States, including my own State of Connecticut, with 18 percent which we've just raised. Illinois doesn't have any. It seems to me from the testimony we're getting it's a national problem. Why shouldn't we have a national response on this problem if we were willing to have one on funeral homes?

Ms. Broadman. Let me explain why usury ceilings have not created a national problem. First of all, the States are moving to raise or lift low ceilings. In contrast, with the funeral home situation, the States were not acting in concert to remedy some of the problems there. The States are very sensitive to the arguments being made by lenders and the business community about the negative impacts of unduly low-interest rates, and the States are moving and acting.

In my testimony I said that we felt national remedies were appropriate where there was a problem that was not being redressed on the State level. Because the States are moving, we don't see a compelling need for Federal legislation. We caution in the statement against Federal preemption of State law. It's obviously a drastic remedy for the Federal Government to come in and erase laws that the people's elected States representatives have voted for. So we would caution against preempting State laws unless there is a national problem. We don't think there is one. We don't think that the record establishes that there is one or that the States will not resolve these problems.

Mr. Boyle. I would like to underscore, if I could, what Ellen had to say. You're talking about dismantling something that many, many States have done, whereas in the funeral home situation the problem was perhaps that the States had not acted. You weren't reaching into this to dismantle and I think that's a crucial difference.

Ms. Broadman. I'd like to make another point, too. Usury ceilings are tied into other aspects of consumer credit regulation in States. They are not totally independent. The States that have

tended to have higher usury ceilings also adopted stronger consumer protections. So there's an interwoven relationship and if the Federal Government comes in and eliminates the usury laws States like Arkansas are going to experience significant difficulties.

Senator DODD. Would you make or have you made any—I didn't note any here—specific recommendations of consumer protection recommendations if we were to proceed with the Lugar or the Pryor-Bumpers approach? Do you have any specific recommendations as to what consumer protections ought to be included in the legislation being proposed?

Mr. SCHECHTER. I was going to say, if it is a national problem, other aspects of the general economy must be considered at the same time. In other words, it has to have responsible national legislation which prevents the interest rates from getting into a panic situation where it gets so high that everybody gets hurt. And S. 1406 would eliminate the rather general ceiling for business loans which was placed in the Federal preemption bill in 1980.

I think there is every indication that the move to get Federal relief by the lending industry is a push to say, "Leave it all to us," and I think this is going back a long way in our history when we had all sorts of finacial problems.

Ms. BROADMAN. We do have specific recommendations in our testimony. They basically fall into two categories. The first category would be default protection for consumers. If you raise usury ceilings, you will increase consumer defaults and abusive default practices. So there's a need for protection against some of these. We cite wage assignments as a type of unfair practice that should be banned. The other category of national consumer protection we would want to see are protections against fees that are excessive and unfair and that really belong in the interest rate—the annual percentage rate. If usury ceilings are lifted so lenders can charge higher interest rates, they shouldn't be allowed to charge these fees.

Senator DODD. You would take that away from the States, the charges that go on? You would suggest if we're going to preempt in the ceiling area that we should then also get into the charges?

Ms. BROADMAN. I would not preempt State laws. I would just establish minimum consumer protections against unfair charges and unfair collection practices, but allow the States to adopt more protective laws if necessary.

Senator DODD. My time has expired.

Senator LUGAR. Thank you, Senator Dodd.

Senator Dixon.

Senator DIXON. Thank you, Mr. Chairman. I want to thank the panel for their contribution to our discussion about these two bills and I'd like to just kind of walk through the history of this thing as I recall it with you, and then ask you a couple questions and come to my bottom line problem, my narrow problem, with what you're telling us here.

First of all, I think that there are two philosophical problems all wrapped up in these bills. The first question is whether you believe in usury rates or things of that kind at all or whether you believe in the free market theory that the rates will achieve their own

level according to the competitive system in our economy. That's one, I think, clearly.

And the second—and I think more important for those of us on this panel—is the overall question of preemption, the question of whether we ought to make the usury issue here in the Congress or leave it to the respective States.

I went to the Illinois House in 1951 and in those days we had an 8-percent usury rate. Of course, in those days, when I borrowed money for my first home I paid 5 percent and when I borrowed money for a little law building downtown I paid 5.5 percent. The 8-percent usury rate didn't bother anybody very much.

As interest rates began to rise in subsequent years, I recall casting several votes on the usury question. I think at one time I voted against raising the rate. I think in 1960 I voted to raise it. There were a number of increases in the rate over the years as I was State treasurer in the 1970's and then secretary of state. I think they finally tied it to something last time, and this June they finally eliminated the rate altogether. So I suppose Illinois is one of the six States that you have suggested that now has no usury limitations of any kind.

Now as I look at the records I have seen here, apparently most States have ceilings that are not too bad now. That is to say, that lenders can live within the limitations effective in the States. My own information is that five States have usury ceilings below 15 percent right now. Is that approximately what your information is? Then, in the other 34 that have ceilings, I think most of them are ceilings that generally one could say you could live with.

Now I suppose the point is really moot for a Senator from Illinois, since we have no ceiling at all now, aside from the philosophical question of whether the Congress ought to do anything with respect to the respective States.

But what bothers me is when we come down to the narrow case of Arkansas, with a 10-percent ceiling put in its constitution 100 years ago that is affecting what's occurring in that State now. Let's just take the narrow case of Arkansas.

With all due respect for all of you, and particularly I'm not picking on you, Mr. Schechter—I appreciate everything you've said here—but I wonder if the AFL-CIO would always take the view you take about Arkansas solving its own problem in respect to elections in Arkansas to amend the constitution.

For instance, when I was a kid, you could have elections on a referendum to build a new school and people would sometimes vote for it. Particularly in education, you could pass tax rate increases once in a while in those days 30 years ago. You could pass a rate for a park district and sometimes to build a public building.

ARKANSAS' OWN PROBLEM

But I would suggest that my own recent experience in my State has been folks just won't vote for those things any more. And so I wonder whether you come here to us offering a solution for Arkansas when you say let Arkansas worry about their problem.

I think the point that I'm trying to make with you is I wonder whether under the best case theory we can do anything for Arkansas by leaving it to Arkansas or whether we need to address the

problem in some way, as my colleague from Connecticut has suggested, by at least narrowly treating the problem for places that can't live with what they have now?

Mr. SCHECHTER. I suppose I don't follow you. I'm sorry, but in Arkansas just last year, the people took two votes. Of course, they have had some slowdown, I suppose, in their economic development, but then their history is they know they make up for it as soon as we start recovering. They recover faster because they don't have the burden of high costs then which drains incomes from them. In other words, we can't look at it just at the moment. That's why with the experience of 100 years I think they have come to the wisdom that this is not a bad thing.

Now it's as though you and I were bargaining if you wanted to sell me something and I said, "At that price, you keep it." That's what they have been saying to the lenders. It means some sacrifice at some point, but they come out all right. They have done all right over the 107 years and that's the way they choose to keep it. I don't see why we should really upset the one example we have where there is a concerted consumer feeling or bargaining, if you will, with lenders and doing it successfully.

Senator DIXON. If I may interrupt you, Mr. Schechter, I might suggest that a great many States other than Arkansas might take the same position if it was left up to them in a popular referendum. So in the days when the market rates are 15 for an ordinary mortgage and 21 or whatever they are today for a prime rate, you would be satisfied to leave a number of the States of our Union in a situation where the rate in that State by the laws of that State—the constitution in the case of Arkansas—was 10 percent?

Mr. SCHECHTER. The rates wouldn't stay at 21. As you know, Senator, last year we got mortgage rates in 3 or 4 months down from 16 to 11 and the prime rate from 20 to 11.

Senator DIXON. I pray that happens again this year.

Mr. SCHECHTER. You think it will?

Senator DIXON. I say I pray that it will. I don't think it will, but I pray that it will.

Mr. SCHECHTER. There was something different done last year for the first time in our history. We did what some other countries are doing. We used some credit controls. Now, admittedly, they weren't everything everybody would like, and I refer more to the credit controls on the banks rather than the consumer credit controls which I think were not the most effective. I mean, not the most effective from the point of view that nothing would come from it.

But Japan, France, Germany, to some extent, have been using controls—they have been making advances. The last advance we made was 50 or 60 years ago when we created the Federal Reserve System. It's time for another kind of intervention.

Senator DIXON. May I summarize at least the position of this Senator by saying that a good deal of what you have said here appeals to me and for this Senator at least you would make a better case if you could address the issue raised by my distinguished friend from Wisconsin—protecting consumers through full disclosure—and also in dealing with these problems that clearly are not being dealt with locally. While I believe in leaving things to the States and my votes indicate that as recently as yesterday

when we had a question on motorcycles—while I believe in that, you have to understand that sometimes they do not effectively deal with their problem and then it's a problem for us here.

Mr. SCHECHTER. Yes. I'm certainly not an advocate of States rights. I believe in Federal Government. But I do think that at the same time, if we go to the national scene, we shouldn't be trying to compartmentalize the financial structure of the country. We've got to take a broader look.

Senator DIXON. I thank you. I thank the Chair.

Senator LUGAR. Thank you very much, Senator Dixon.

Mr. Schechter, this is not meant just to pick on you today, but that's an intriguing argument that's almost irresistible. I'm wondering if in fact the State of Arkansas had 107 years, or however long it took to get the usury thing in the constitution, had also indicated that labor unions could not organize in the State of Arkansas and again and again people had voted to keep that in the constitution, would you argue that there was no national cause that was overriding, that in fact, if the people of Arkansas wanted to have no unions, they ought to have that privilege?

Mr. SCHECHTER. I'm sure we would make every attempt—State and Federal—of course, to get a law that would permit union organization.

Senator LUGAR. Let's say you fail again and again. They kept voting down the union.

Mr. SCHECHTER. We would try to convince the people first and——

Senator LUGAR. Then what would you do?

RIGHT TO WORK LAWS

Mr. SCHECHTER. We do have States where we have right to work laws that we don't like and we fight that battle at each State legislature.

Senator PROXMIRE. And also here in Washington.

Mr. SCHECHTER. Also here in Washington, when necessary. But we do fight it there and I will say that, sure, we would do that.

Senator LUGAR. I think this is one of the things we have to judge. It's not an open and shut issue. But clearly, as I indicated earlier, last year in the deregulation of banks and lending institutions with regard to mortgage financing, for example, we said this ought to be handled as Federal policy and essentially that's been deregulated. We are looking at a narrow part of the market, the consumer credit, a very important part, trying to determine whether it's unique in its characteristics so it should not follow the general deregulation which we have seen as a national situation.

Mr. SCHECHTER. Well, Senator, my argument is not on the basis of whether it should be at the State or national level so much as to whether we're talking about an effective remedy, and I don't think what is being proposed is an effective remedy.

Senator LUGAR. I understand.

Senator PROXMIRE. Let me just take a minute and I do apologize because we have other witnesses, but I'd like to say I support your position very strongly on right to work. I think that union shop is right. I was an employer with a union shop in a company I was owner of before I came to the Senate. It worked very well, I

believe, with the union shop and you have every right to do what you're doing to persuade us in Washington to prevent the States from going on the right to work basis, but that's inconsistent with what you're doing now—that we shouldn't adopt a national policy with respect to capital.

Capital seems to me about as mobile a product as you can get. It flows so easily from one market to the other, from one State to the other, and the Constitution, article I, section 1, paragraph 8, says Congress has the right to coin money and regulate the value thereof. We have the money power. It's a national power. So here, it seems to me, of all areas, we have the constitutional responsibility to act with respect to credit.

Mr. SCHECHTER. I agree on regulating the value of money. We have the Federal Reserve for controlling the supply. It comes from the coinage. I believe historically it developed from the chipping of coins and therefore the sovereign has the right to control the value of the money, but that doesn't mean that the sovereign has to have the right to control interest rates for consumers.

Senator PROXMIRE. We don't have to have it, no, but because of the great mobility and the fact that money is just drained out of the State of Arkansas on this basis. One other point and I'll be through. That is that the statistics that you give on the referendum, it seems to me astonishing that you can get 30 percent or 35 percent of the people to vote in favor of letting interest rates go higher. It's the hardest thing in the world. You won't find—if I would go out to Wisconsin and talk to bankers and I talk to most conservative people, and they are all against high interest rates. We are all against that. The easiest thing in the world is to vote for low interest rates. So that referendum doesn't kid me. I mean, you have two Senators that also have been Governors and know that State thoroughly and have lived with the people, have lived with this problem year after year in Arkansas, and it seems to me it's very hard for us to walk away from their advice if they say they urgently have to have this kind of Federal action.

Mr. SCHECHTER. Senator Proxmire, I think still we have to pay attention to majority vote and, in addition, as I don't have to tell Members of the Congress, the resources in the campaign do sway the vote, and I can assure you the resources in the campaign to eliminate or raise the ceiling in the Arkansas constitution have been much greater in those campaigns than the resources that are devoted to defeating that.

Senator PROXMIRE. I'll give them the resources if I could have an issue as simply as that. It's so easy to convince people to vote no on higher interest rates.

Senator DODD. I find it astonishing that New York decided to eliminate them pretty much altogether. I think New York voted for total elimination, which is staggering. Now it wasn't done by referendum. It was done through the legislature and I don't know what happened.

Senator PROXMIRE. In that case the banks wouldn't give credit in New York.

Senator DODD. They were threatening that in Arkansas. In fact, they have just lifted all ceilings—it's striking to me—in Illinois. Was that a decision of the State legislature?

Senator DIXON. Yes; and by a very close vote I think.

Senator LUGAR. Thank you again, Senators. And panel, we appreciate your coming to testify.

The Chair would like to now call the next panel. Mr. Lee Gunderson, president of American Bankers Association, Osceola, Wis.; accompanied by Mr. Dennis D. Dumler, vice president, Colorado National Bank, Denver, Col.; Mr. Fred Hammer, executive vice president, Chase-Manhattan Bank, New York, on behalf of the Consumer Bankers Association; and Mr. Charles T. Russell, president, VISA, USA, San Francisco, Calif.

Senator PROXMIRE. Mr. Chairman, before the witnesses begin, may I say welcome to Mr. Gunderson. We are very proud of Mr. Gunderson. He's done a marvelous job as head of the American Bankers Association and the association of banks in the country, and I understand that he may be leaving office fairly soon. We hope he won't. We hope he will run for reelection.

Mr. GUNDERSON. No way, Senator. Thank you.

Senator PROXMIRE. He's done a super job.

Senator LUGAR. Thank you, Senator Proxmire, for your introduction of your distinguished colleague, and I'll call upon the gentlemen to testify in the order that you were introduced. First of all, Mr. Gunderson.

STATEMENT OF LEE E. GUNDERSON, PRESIDENT, AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY DENNIS D. DUMLER, VICE PRESIDENT, COLORADO NATIONAL BANK

Mr. GUNDERSON. Mr. Chairman and members of the subcommittee, my name is Lee E. Gunderson, president of the Bank of Osceola, Osceola, Wis. I am testifying today in my capacity as the president of the American Bankers Association. Rather than read our complete statement, I will summarize our salient points, recognizing that our written statement will be included in the record in its entirety.

Senator LUGAR. It will be.

[Complete statement follows:]

STATEMENT OF THE

AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is Lee E. Gunderson, President of the Bank of Osceola, Osceola, Wisconsin. I am testifying today in my capacity as the President of the American Bankers Association. The Association's membership consists of more than 90% of the nations full service banks; including more than 12,000 community banks with deposits of $100 million or less. Accompanying me today is Dennis D. Dumler, Vice President of the Colorado National Bank, Denver, Colorado and past Chairman of the Bank Card Division of the American Bankers Association.

The Association welcomes this opportunity to present its views on S. 1406, the Credit Deregulation and Availability Act of 1981 and S. 963. Both S. 1406 and S. 963 provide for a federal preemption of state usury laws, although S. 963 is limited in scope and duration and is of limited value to federally insured depository institutions.

With increasing costs of funds to financial institutions and upward pressure on interest rates, banks located in states with restrictive usury celings are unable to meet the credit needs of their customers, particularly in the consumer loan area. As a result of these pressures, the need for federal preemption of all state usury ceilings has become a major goal of the financial industry.

The idea of a federal preemption of state usury ceilings is not new to Congress. Congress has previously recognized the need to preempt state rate ceilings in the pursuit of national policies. In 1933, Congress first preempted state limitations as applied to loans made by national banks. Congress authorized all national banks to charge at least one percent in excess of the discount rate regardless of the state rate. The stated purpose of this legislation was to

amount in the development of a strong national banking system. In effect, Congress recognized that lenders needed the ability to vary their rates as market rates varied.

Congress again acted to override state rate limitations in 1974. Title II of Public Law 93-501 provided an override of state limitations for national banks, and federally insured banks and savings and loan associations on business or agricultural loans in excess of $25,000. This preemption was temporary in nature and expired on July 1, 1977. Congress recognized that in certain states "the financial industry has been caught in a pinch because of the high price it must pay for money" and that hardest hit would be "the construction, agricultural and small business firms." (Senate Report No.93-1221, p.3)

Last year Congress enacted the most extensive preemption of state limitations to date with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221.

Title V of P.L. 96-221 preempts state usury ceilings for first mortgage residential real estate loans, and mobile home loans with no cap on the amount of interest that may be charged. States were given three years (before April 1, 1983) in which to override this federal preemption.

Ceilings on all business and agricultural loans over $25,000 were preempted for three years, after which state law shall prevail. The ceiling allows creditors to charge up to 5 percentage points above the Federal Reserve discount rate (including any surcharge). During the three year period, a state may act to reimpose ceilings on such loans. The usury preemption on business and agricultural loans was further

extended by Section 324 of the Housing and Community Development Act of 1980 (P.L. 96-399), to decrease from $25,000 to $1,000 the threshold amount required for a business or agricultural loan.

In addition, P.L. 96-221 extended to all federally insured depository institutions the authority granted to national banks to charge at least one percent in excess of the discount rate.

These steps taken during the 96th Congress to deregulate interest rates were certainly in the right direction, but they were also selective and did not cover all types of credit extensions.

While the Federal Government has taken an active role in impacting the liability side of the ledger, it has, with the exception of those limited actions in the 96th Congress, left the regulation of the asset side of the ledger up to the individual states.

Recent developments in the money market place highlight the need for action at the federal level. More and more, customers are demanding a market rate of return on their deposits. However, with the creation of new depository instruments which yield such a return, come increases in the cost of funds which can be lent. This, coupled with the upward pressure on costs to depository institutions brought about by the phase out of Regulation Q, increases in the cost of federal funds and the added strain resulting from reserve requirements, increases the need for financial institutions to be able to charge a market rate on their loans.

State usury ceilings governing the amount that creditors can charge on the money they lend are often the product of inefficient and outmoded concepts of so called "consumer protection." Given today's increasingly dynamic money market, creditors are no longer able to

assure the reasonable availability of funds for consumers when restrained by artificial rate ceilings from earning interest at a rate that reflects the cost of their credit extensions. Due to the growing divergence between state usury ceilings and current economic realities, action must be taken if the reasonable expectation of credit availability held by an ever larger number of Americans are to be met.

Most of the rate limitations applicable to consumer credit today are the results of laws providing exceptions to the general usury limits of the state. The net result is a hodge podge of legislation in most states that has little if any relationship to modern commercial and economic realities. A state may have different laws with different limits regulating loans by commercial banks, industrial banks, consumer finance companies, and credit unions. There may be different laws for new motor vehicle sales, used motor vehicle sales and other sales financing. There may be separate limits applicable to mobile home lending and second mortgage loans. Finally there may be separate statutes for revolving credit plans and bank overdraft checking credit lines.

The recent wide fluctuations in interest rates result from attempts by the federal government to bring under control the rampant inflation which has done so much harm to our nations economy. While individual states have little impact on factors associated with rising costs, actions by the federal government have a direct relationship both to the cause and the cure. We are already seeing monumental steps being taken by the Administration and Congress to reduce

inflation through massive budget cuts aimed at reducing the federal deficit.

In addition, it should be noted that individual states have no impact on the factors associated with the cost of a financial institutions' management of its liabilities (e.g., deposits). It is the federal government which has intervened to regulate the liability side of the ledger. We expect that the federal government will continue to play a major role in regulating the availability of money and its corresponding costs, in its attempt to control inflation. For the most part, this task has been assigned to the Federal Reserve which is charged with the conduct of monetary policy. Congress too, however, continues to play a vital role in its attempt to work in concert with the Fed. Recent Congressional initiatives such as the phasing out of regulation Q and the imposition of universal reserve requirements, which financial institutions must maintain on certain deposits, have a major impact on the costs associated with a depository institutions' management of its liabilities. These factors, when coupled with the effect of competition among financial intermediaries for deposits (which Congress has decided not to regulate), amplify the need for federal intervention to deregulate the asset side of the ledger (e.g., loans)..

Mr. Chairman, I applaud the actions of this Subcommittee in convening timely hearings on this vital issue shortly after the introduction of S. 1406 and S. 963. We would also like to thank Senator Lugar for recognizing the need for an across-the-board preemption as is embodied in S. 1406, along with Chairman Garn and Senators Proxmire and D'Amato for their support by co-sponsoring S.

1406. While we also appreciate the interest voiced by Senators Bumpers and Pryor in introducing S. 963, the Association does not believe that this legislation will serve the combined needs of creditors, retailers, manufacturers and consumers to the extent necessary to insure the continued availability of credit nation-wide.

Specifically, S. 963 would authorize any person to lend at a rate of not more than one percent in excess of the discount rate plus any surcharge in effect at the Federal Reserve bank in the Federal Reserve district where the person is located. S. 963 would substitute a federal rate ceiling to be compared with state ceilings to determine when a preemption exists. The Association opposes any form of rate ceilings whether imposed by the states or Congress. Ceilings have been demonstrated to perform no useful function. As described more fully below, ceilings, however well intended, often produce unintended and detrimental effects on consumers and lenders. For this reason, we cannot support S. 963.

While the concept of indexing ceilings to the discount rate is not new, as demonstrated by last years partial preemption on business and agriculture credit contained in the Monetary Control Act, the Federal Reserve Board has consistently opposed the use of the discount rate for purposes of indexing permissible loan rates. The Board continues to argue the fact, and rightfully so, that the discount rate is an administered rate which is used in conduct of monetary policy and does not necessarily reflect the true cost of money in today's marketplace. In other words while the discount rate is frequently below market rates, credit by commercial banks at the discount window is rationed through administrative means.

Under normal conditions, the interest rate on loans is set by supply and demand, which is influenced by the cost of funds, administrative costs, risk, Federal Reserve policy and other factors. The tying of the interest ceiling to the discount rate prevents the forces of supply and demand from determining the loan rate in times of rapid changes in the cost of funds. The discount rate, which is set by the Federal Reserve, normally lags market interest rates and is adjusted after the other rates have changed. In times of large and rapid changes in other interest rates governing the costs of funds, the Federal Reserve may choose not to change the discount rate, thereby limiting the interest rate on loans. Also, the discount rate is a short term rate while much of the lending by commercial banks is long term lending. The long term rates do not necessarily move in concert with the short term rates, causing the ceiling to be indexed to a rate of the wrong maturity.

These same concerns relate to the use of the discount rate plus the surcharge as an index to federally imposed rate ceilings as contained in S. 963. The surcharge, like the discount rate, is an administered rate used to control the supply of money. The purpose of the surcharge is to restrict repetitive borrowings by commercial banks at the Fed's discount window. Since, there is no way of predicting the Fed's continued use of this tool of monetary policy, we do not believe that it is appropriate to consider such as an index to any law restricting loan rates.

If in fact the time has come for the Congress to recognize the need to deregulate the asset side of the ledger, such action should be true deregulation, not simply re-regulation. S. 1406 follows the

positive course of deregulation while S. 963 moves from one form of restrictive regulation to another.

S. 1406 furthers two very important goals which the Association continues to pursue in the public interest: an across-the-board preemption of all state usury ceilings on business, agriculture and consumer credit transactions; and the authorization of certain card usage fees. Specifically, S. 1406 contains provisions that would:

- eliminate the threshold amount of $1,000 on business and agriculture loans as contained in the Depository Institutions Deregulation and Monetary Control Act of 1981;
- eliminate all ceilings on business and agriculture loans presently set at 5% above the discount rate;
- make permanent the preemption on business and agriculture loans subject to a state override within three years of enactment;
- preempt state laws that limit the nature, rate, amount or manner in which interest, finance or other charges may be charged on extensions of consumer credit;
- preempt state laws prohibiting the imposition of transaction or annual fees in conjunction with open end credit plans;
- provide that state and federal consumer protection provisions are not affected by eliminating usury ceilings;
- permit states to override the preemption within three years of enactment (by adoption of a law or voter resolution);
- give the Federal Reserve Board limited interpretative authority as to the scope of the consumer credit preemption;
- permit federal credit unions to charge interest at the same rate allowed other lenders under the preemption;

The American Bankers Association wholeheartedly supports the provisions contained in S. 1406 in their entirety and urges its early enactment as presently drafted.

Clearly, on numerous occasions, Congress has recognized the problems faced by financial institutions, small businesses and consumers when national economic policies govern the cost of funds, while state laws place limits on rates that can be charged for those funds. S. 1406 represents a logical extension of the process begun in 1933 and so strongly recognized by this committee.

The rationale for establishing and maintaining usury ceilings on consumer credit is primarily based on three socio-economic intentions:

1) To make credit readily available to the general public at low cost;

2) To protect consumers from unscrupulous lenders by establishing "fair" prices for consumer credit; and

3) To achieve uniform rates for all borrowers in the market.

Numerous studies have been done to test the effectiveness of usury ceilings. Remarkably, the vast majority of these studies have come to the similar conclusion that usury laws, while well intended, often produce unintended and detrimental effects on consumers, lenders, markets and the economy. Empirical evidence consistently supports competitive market pricing as being clearly superior to legislatively imposed usury ceilings. Attachment A to our testimony is a selected bibliography of literature on this issue.

In addition to the research done by the private sector, the federal government has examined usury and its effects. The Report of the National Commission on Consumer Finance submitted to Congress in December of 1972 examined the popular theories supporting rate ceilings as necessary for consumer protection and concluded that they did not stand up under scrutiny. The Report concluded that rate ceilings are undesirable.

More recently, the Report of the Interagency Task Force on Thrift Institutions, submitted to Congress last July, concluded that rate ceilings were a disincentive to thrift institutions' entrance into consumer lending as authorized by the Depository Institutions Deregulation and Monetary Control Act of 1980 and that the ceilings should be removed or set at higher levels. Other studies indicate that, beyond lacking a consumer protecion rationale, rate ceilings are harmful to the very individuals and businesses they are designed to protect.

Empirical evidence shows that usury ceilings have the following generally detrimental effects on consumers:

- Rate ceilings cause lenders to ration credit by lending to only the lowest risk customers, and by denying loans to less creditworthy consumers. However, because there are variations in the relative creditworthiness of consumers, people should pay different rates based on variations in costs to service them. Logically, better (lower) credit risk borrowers should pay less interest than greater credit risk borrowers. The fact is that lenders tend to accept greater risks as usury rate ceilings increase, and they are more willing to make loans available to a broader segment of the market. On the other hand, usury ceilings that ignore market costs, cause lenders to reduce credit availability to borrowers who have the greatest need. Low rate ceilings force creditors to raise the level of credit scores required to obtain a loan, thereby penalizing both creditworthy and higher risk con-sumers. However, the heaviest impact of such credit rationing falls on lower-income consumers.

- Prices of goods and services are higher in states with restrictive lending rate ceilings than in surrounding states with more liberal rate structures. For example, a 10% usury limit in Arkansas effectively dried up the availability of credit and raised the cost of retail products so that residents were forced to shop for automobiles, appliances, furniture and other goods in contiguous states having more liberal rate ceilings.

- Usury ceilings force some consumers to acquire more costly credit elsewhere (i.e., from illegal lenders at higher rates).

- Lenders in low rate states tend to eliminate smaller, short term loans. Therefore, borrowers in these states are often denied access to credit.

Reduced to basics, a lender's rates are determined initially by consideration of four primary factors: cost of funds; acquisition, operating and other administrative costs; risk premium; and the need to earn a profit for shareholders. Beyond these factors, the lender's rate is set at the lowest level possible in order that borrowers may be attracted from competitive lenders. In effect, supply and demand set the market rates.

As the costs associated with extending credit approach or exceed the usury ceiling, the market is constrained from working freely, and is thus unable to allocate credit in the most efficient manner. As a general rule, when faced with restrictive usury ceilings, lenders will reduce their extensions of credit and move funds that would have otherwise been extended to borrowers to better return situations.

Clearly, these options are not in the best interest of the majority of the borrowing public, since many consumers who need credit will be unable to obtain it. The adverse impact of restrictive usury ceilings is greatest on the less sophisticated and less affluent consumers, as well as first time credit seekers, who can least afford being shut out of the credit market. Since the risk premium is generally the greatest for these consumers, they will either be totally shut off from legitimate credit markets when the cost of granting loans approach the usury ceiling, or be able to obtain credit only under much more stringent terms (e.g., higher down payment, shorter maturity) which they can often ill afford.

Not only are those seeking credit disadvantaged by the artificial constraints placed on the pricing of credit, but the providers of goods and services, particularly small businessmen, are also injured since their potential customers can no longer obtain financing. For example, during the recent period of high interest rates, automobile dealers and home builders were frustrated in their attempts to maintain sales and employment levels partially due to the inability of consumers to obtain financing.

There is also ample evidence that usury ceilings have detrimental effects on lenders. Some lenders have been forced out of the credit market altogether, particularly in the area of bank card credit plans. For example, last March, a regional bank in the mid-west divested itself of its entire bank card operation of over 175,000 accounts and $40 million in outstandings. Just last month, the American Banker reported that a large Chicago bank was ready to sell its entire portfolio. In these cases and in numerous others the squeeze between high costs of funds and state usury ceilings were cited as a controlling factor in the decision.

For the most part, smaller institutions are disadvantaged more than large lenders since their volumes required to break even are higher. The resulting impact of restrictive ceilings could leave the field wide open to the larger institutions located in money center states who will have the ability to price their services any way they wish, and eliminate the opportunity for smaller institutions to offer many credit services. This can be illustrated by looking at the three largest money center states (New York, Illinois and California), all of which have acted to remove usury ceilings. These states house the

nations largest credit card issuing banks, which service cardholders in virtually every state in the union. Obviously, institutions located in states with restrictive ceilings cannot compete.

Several arguments are advanced in support of rate ceilings. The first assertion is that if rate ceilings were removed, lenders would charge rates far in excess of costs. This theory ignores competition among lenders and assumes that borrowers are unaware or unable to compare the costs of credit. In states with no legal rate ceilings governing commercial banks (e.g., California), competition between lenders keeps them from charging more than the market rate. Conversly, vigorous inter- and intra-industry competition does not exist where rates are artificially constrained.

Additionally, the Truth in Lending Act insures that consumers are made aware of the annual percentage rate and the dollar figure of finance charges involved in consumer credit. Recent studies indicate that this, and other factors, have led to a high percentage of consumers who are aware of interest rates.

The second theory advanced in support of rate ceilings is that in the absence of rate ceilings, credit would become too easily available to consumers, causing them to become overextended. Experience in states where rate ceilings have been eliminated does not substantiate the theory on overextensions. Lenders have, and will continue to act responsibly in seeking to determine valid credit risks.

In summary, studies of state usury ceilings have dismantled the consumer protection and economic arguments in support of usury limits. The time has come to eliminate the disruptive effect which usury

ceilings have on the economy, and the free interaction of the credit marketplace.

* * * *

S. 1406 would also make an additional reform in the area of bank cards by authorizing annual, monthly or periodic fees and transaction fees. The prohibitions that exist on these fees in many states create an unfair burden on lower-income consumers and contribute significantly to the unprofitability of card programs.

In many states, card issuers are required to give users a "free period" in which to pay all charges incurred without any charge for the convenience involved in this payments mechanism. As a result many consumers use their cards simply as a convenient payment device — an alternative to cash or check. The card issuer incurs considerable expenses in processing purchases and payments and in extending funds during this period of "free use" but collects no finance or use charge. A study commissioned by the Massachusetts Bankers Association (Credit Card Profitability Study; Peat, Marwick Mitchell & Co., February 1980), found that 35% of all cardholders involved were free users i.e., their usage was not subject to any credit or usage charge. While this 35% figure is significant, even more so is the fact that these same cardholders represent approximately 50% of the total dollar outstandings.

Visa U.S.A. reported recently that these "free users" were subsidized by active card users to the extent of $661 million in 1979

and a subsidy of $835 million in 1980. For the most part, these "free users" tend to be the more affluent cardholders. S. 1406 would enable card issuers to insure that those who use their card only as a convenient method of payment would bear a fair share of expenses for their involvement in a payment, not credit, mechanism.

The adverse impact of restrictive state card fee legislation on industry and consumers is illustrated in a recent study conducted on behalf of the Credit Research Center at Purdue University (Working Paper No. 35 - Restrictive Effects of Rate Ceilings on Consumer Choice; The Massachusetts Experience). That study concluded that credit card users who pay in full, thus incurring little or no finance charges, are being subsidized by those cardholders who make extended payments on their accounts. On average, the consumers receiving this subsidy have higher incomes and use their accounts more frequently than those providing the subsidy. S. 1406 by authorizing creditors to impose periodic or transaction fees, would enable card issuers to eliminate this subsidy and provide a more equitable fee structure for all credit card users, thus enhancing competitive alternatives.

Visa U.S.A., Inc. has released figures showing that the bank card industry had a loss equal to 1.1% of average outstandings in the second half of 1979. As a result of the high cost of funds, the Visa system suffered a loss of over $335 million in 1980. During the first quarter of 1981 Visa system wide losses grew to a record 2.4% of average bank card outstandings. These losses are the direct result of the card issuers inability to earn a rate of return from the "free users" of the cards and the inability to raise rates as the lenders' cost of funds rises.

The Massachusetts Bankers Association, Credit Card Profitability Study, demonstrated the unprofitable status of bank card operations of seven banks in that state. The study covered 1979 - a period prior to the escalating cost of funds in early 1980. That study showed that the cost of funds would have to dip to 6.68% for card operations to become profitable unless usury laws, or laws prohibiting credit card fees were changed. In Massachusetts, banks can charge only 12% on credit balances over $500 and 18% on balances under $500.

Approximately 35% of cardholders involved in the study who used their cards paid off the balance within 30 days without paying finance charges. As a result, less than one-half (43%) of all cardholders paid the total finance charge. The study also showed that inflationary costs of labor, supplies and services plus the creditors' inability to increase finance charges contributed to unprofitability.

The study concluded that unless the rate ceilings were raised, the only means of avoiding unprofitable operations was to eliminate unprofitable accounts (i.e. free users) or withdraw from credit card operations. Imposition of fees on use of the card as a payments vehicle would allow the card issuer to realize a fair return on the unprofitable accounts.

Experience in individual banks is similar. Figures for one large New York bank (reported in the American Banker) indicated that the cost of funds would have to drop to 6% before a pre-tax profit of 2% could be achieved on bank card operations. We are not optimistic that this decline in the cost of funds is achievable in the near future.

* * * *

The reforms proposed by S. 1406 will have an extremely positive effect on small business. Elimination of usury ceilings will remove the artificial constraints which make it necessary for creditors to divert funds from consumer lending to other, more profitable investments during periods of high interest rates. This will insure the more constant availability of funds for consumers that is vital to the health and vitality of small businesses.

Recent experience indicates the disastrous effects a period of high interest rates coupled with restrictive state ceilings can have on small businesses. For example, automobile dealers, despite aggressive marketing, were frustrated in their attempts to reduce their high inventories due partially to the inability of consumers to obtain automobile loans.

As interest rates soared, the small merchant felt the crunch first. Sales decreased because the small merchant does not have access to sufficient funds for consumer lending during a period of tight credit. A large retailer operating its own credit program can better afford to absorb losses on credit operations because of potential profits on sales. Many small businesses do not have this luxury, and must rely on credit extended by third parties.

The authorization of card fees will also help small businesses which rely heavily on independent credit programs such as bank cards. By accepting a bank card or a number of different cards, the small merchant is able to avoid a costly, inefficient, in-house credit program while, at the same time, enjoying the benefits of increased

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sales that result from the convenience of credit. Card fees would help to insure the vitality of these essential programs.

In conclusion, we emphasize the pressing need for the reforms contained in S. 1406. The economic health of the consumer credit industry is dependent on these reforms. Studies and literature on usury and bank card fees indicate that the reforms proposed by S. 1406 would be beneficial to lenders, merchants and consumers.

We commend the efforts of this subcommittee in providing a forum where these important problems can be aired. We appreciate this opportunity to discuss these issues and make our views known.

ATTACHMENT A

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Senator LUGAR. Thank you very much, Mr. Gunderson.

I will now call upon Mr. Fred Hammer for his testimony.

STATEMENT OF FRED HAMMER, EXECUTIVE VICE PRESIDENT, CHASE MANHATTAN BANK, NEW YORK, ACCOMPANIED BY PETER SCHELLIE, COUNSEL

Mr. HAMMER. Thank you, Mr. Chairman. I am Fred Hammer, executive vice president of the Chase Manhattan Bank, N.A., and a member of the Board of Directors and the Government relations committee of the Consumer Bankers Association. Accompanying me today is Peter Schellie, counsel to the association.

We greatly appreciate this opportunity to discuss one of the most critical issues facing the retail banking industry: namely the continued imposition of arbitrary governmental price controls on a commodity—money—in the form of usury laws.

Within the past year, the association has had several opportunities to testify here. On each occasion we have detailed our concerns about governmentally imposed rate ceilings. The problems dis-

cussed in previous hearings continue unabated, and in fact, have intensified. I would like to discuss these matters briefly before commenting on the legislation now pending before this Committee.

Usury laws were first adopted hundreds of years ago in the context of a noncommercial society. Upon contemporary review, it is apparent that these controls now reflect outmoded "consumer protection" concepts that cannot be supported on either economic or social grounds.

USURY LAWS PRODUCE ECONOMIC DISRUPTIONS

The fundamental starting point in analyzing the justification for usury ceilings must be the basic American concept of a competitive market operating within a free enterprise system. Usury laws run counter to that basic premise and clearly produce economic disruptions. In addition to creating often unfair subsidies among consumers, they cause economic harm at a more general level. As examples, a 1977 study of the Tennessee economy estimated that the State usury ceiling caused the loss of 7,000 jobs. During the past 15 months, a major bank in Maryland, due to State usury limitations, has reduced its consumer credit portfolio by $200 million, a reduction of 25 percent. This has resulted in a reduction of 115 employees, approximately 25 percent of those involved in consumer credit.

In the case of my own bank, due to usury ceilings, we were forced to stop all credit marketing activities in November 1979, and only recently have restarted those efforts in light of the limited lifting of New York usury ceilings.

In short, the general free market approach that characterizes virtually all other segments of the American economy should apply equally to credit. If credit is to be afforded unique treatment, there should be—but there is not—a clear justification for it.

Three general arguments are said to support usury laws.

The first is that the market is monopolistic, a suggestion that is simply without support. The market is composed of an enormously large number of credit sources and recent legislation has further increased the number of competitors. In New York, for instance, the response to a limited lifting of rate ceilings, has been to provide consumers with more credit and a wider array of interest rates and fees.

It is also important to point out that usury laws are anticompetitive since they discourage even more competitors from entering the credit market.

The second justification for continuing usury laws is that consumers are unaware of credit costs. This is contrary to numerous studies indicating that the literally millions of dollars spent by the credit industry on truth in lending have produced results. In a Federal Reserve Board study, it was found that between 1969 and 1977 the awareness of closed-end rates increased from 14.5 percent to 54.5 percent, while awareness of bank credit card rates increased dramatically from 26.6 percent to 71.3 percent.

The third argument used in support of usury limitations is that they save consumers from overextending themselves. In fact, the growth of credit outstandings is basically similar to the rate of inflation. Furthermore, this argument has been refuted by private

studies that have used both income statement and balance sheet approaches.

In summary, Mr. Chairman, the three bases cited for the continuation of usury laws are simply without foundation in today's society.

Not only do these artificial price controls fail to produce positive benefits, but they actually damage both the economy and the very consumers they are said to protect, for example, by limiting the availability of credit.

A study in connection with banks in Massachusetts demonstrates the problem. The banks surveyed lost $19.67 in 1980 on each open-end account and $1.23 on each credit card transaction.

Although due to customer demand and to provide an overall service package, many banks have continued to offer these programs, that simply cannot continue indefinitely. The losses being sustained in this area are obviously being passed on to consumers of other credit and noncredit bank services. Many banks facing this situation have had to reduce credit availability and will ultimately be forced to terminate this form of open-end credit plan.

For all of these reasons, the association believes that usury relief is necessary and that must be provided at the Federal level. We think that the following factors particularly recommend congressional action.

First: The continuation of usury limitations injures the national economy since the damage cannot be limited to the boundaries of any State. The obvious results of usury limits are homes unbuilt, automobiles not purchased, home improvements delayed, vacations forgotten, and education plans revised. Credit flows through and directly affects a national economic system that operates without regard to political boundaries.

Second: Congress has not abandoned this area of law to the States, but rather has been active in this field for many years. It has played a substantial role by creating duties under a host of consumer protection laws that have given rise to costs that creditors are often unable to recover since they are limited by State usury laws.

Third: Only last week, the Depository Institutions Deregulation Committee scheduled the demise of remaining rate limits on deposits. This will affect the costs of many consumer lenders.

Fourth: The speed and uniformity necessary to address the usury problem can be provided only by Congress.

We believe that legislation now before this subcommittee would provide the necessary relief. Senator Lugar has introduced legislation cosponsored by Senators Garn, Proxmire, and D'Amato that will do much to alleviate the problems that we have discussed today. This bill permits the free market to operate, including allowing creditors sufficient flexibility to price their credit products in a way that reflects the costs of the services involved.

We consider the absence of any arbitrary cap to be critical since, as Dr. Robert Johnson testified last week before this subcommittee, any effective rate restriction has the impact of denying credit availability. It is simply impractical to try to set a single arbitrary maximum rate in view of the wide variety in the types and terms of credit extensions.

By this same token, indexing is similarly flawed since in our experience there is no index that reflects accurately the multitude of factors that must be included in pricing credit services. Indexes tied to some indication of money costs—and none do that accurately—ignore operating and other nonmoney expenses.

Illustrative of the difficulties involved in selecting an index is the suggestion that we use the Federal Reserve Board's discount rate, an administered rate on essentially short-term funds, calculated primarily on the basis of then existing monetary policy. We agree with Vice Chairman Schultz that the use of the Board's discount rate is inappropriate.

LOAN SHARKS

Rate "caps" present significant drawbacks and no benefits, despite suggestions that they somehow are related to and deter loan shark activity. It is highly unlikely that loan sharks are going to be greatly influenced by any form of legal constraints. We have seen no evidence that they follow usury laws, indicating that usury laws hurt only legitimate credit grantors.

Similarly, the use of these laws as a mechanism to prosecute loan sharks is not needed since numerous State and Federal laws—including truth in lending—provide criminal penalties. It is difficult to imagine a loan shark making truth-in-lending disclosures or meeting the duties imposed by the many other State and Federal consumer credit protection statutes.

Finally, if the activity giving rise to concern is truly loansharking, title II of the Consumer Credit Protection Act of 1968 currently proscribes that activity and imposes substantial penalties on those who violate the law—$10,000 and/or 20 years in jail.

The only effective method of preventing loansharking is to allow access to legitimate credit markets, by permitting the free market to operate, as would be the case under S. 1406.

Another desirable feature of S. 1406 is that it leaves in place each State's network of consumer protection provisions. Only those dealing with rates or charges would be displaced, despite suggestions that the language sweeps away more than that. In addition, by preserving the rights of the States to displace the Federal preemption, their prerogatives are respected.

There is also currently pending before this committee a bill introduced by Senator Bumpers and cosponsored by Senator Pryor, S. 963. We commend the thrust behind S. 963. However, we believe that it fails to deal with the larger problem which relates to the very way in which our free market economy operates. The answer is not to simply produce another artificially set Government ceiling—a ceiling that is already of questionable value given current market rates.

In conclusion, Mr. Chairman, usury relief is essential to our industry. As in other segments of our economy, the imposition of arbitrary price controls is simply inconsistent with the proper and efficient operation of a free market economy.

The association respectfully urges early and favorable action on S. 1406 which would provide essential relief in this most important area. Thank you.

[Complete statement follows:]

Presented By

Frederick S. Hammer

TESTIMONY OF THE CONSUMER BANKERS ASSOCIATION
BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE ON THE PROPOSED CREDIT DEREGULATION
AND AVAILABILITY ACT OF 1981 (S. 1406) AND S. 963

Mr. Chairman:

I am Frederick S. Hammer, Executive Vice President of The Chase anhattan Bank, N.A. and a member of the Board of Directors and t. Government Relations Committee of The Consumer Bankers Association.* We greatly appreciate this opportunity to appear before the Subcommittee on Financial Institutions to discuss one of the most critical issues facing the retail banking industry: the continued imposition of arbitrary governmental price controls on a commodity -- money -- in the form of state and Federal usury laws.

Mr. Chairman, we are most pleased to have been invited to discuss with the Subcommittee the continuing problems caused by the patchwork of usury laws. As you know, within the past year the Association has had the opportunity to appear before the

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*The Association is a nonprofit organization that was organized in October 1919 to provide a voice for the consumer banking industry Since that time the membership of the Association has grown to over 390 commercial banks of all sizes that are actively engaged in extending consumer credit. Combined, the members of the Association now hold over 65% of all consumer credit outstandings held by commercial banks. The members' consumer credit outstandings total more than $72,000,000,000.

aimed at ending loansharking by imposing licensing and other regulatory controls on creditors as well as permitting higher rates (normally 3½% per month on $300 or less) on small loans. In time, as this century's demand for consumer credit matured, other exceptions to state usury limits were enacted to permit new forms of credit transactions including pawnbroking, credit unions and retail instalment sale transactions.

Thus the usury laws of the various states are a reflection of inconsistent notions. In part, they are the current embodiment of the ancient social and religious view that lending is, in itself, distasteful and sinful. In part, by their acceptance of special treatment for small loans, retail instalment sale agreements and other credit transactions where the economic risk exceeded the return permitted by the traditional usury limit, they represent an acceptance, albeit slow and grudging, of the merits of the free market system. In short, a long and multifaceted background has given rise to a patchwork of usury laws that simply can no longer be attributed to one central historical justification. As a result it is appropriate to consider arguments often cited in support of the continuation of these artificial government price controls, keeping in mind the moral implications about usury and even lending itself that developed during a vastly different time.

ARGUMENTS FOR THE CONTINUATION OF USURY LAWS

Viewed against this background, it is important to consider the contemporary viability of usury ceilings in light of current

market, economic and social realities. Upon that review, it becomes apparent that price controls -- if they ever served a purpose -- now reflect consumer protection concepts that are outmoded and cannot be supported on either economic or social grounds.

First, it is essential to analyze the context in which this discussion should take place. Second, I will identify and refute the three principal arguments cited in support of the continuation of usury restrictions.

1. The Context

The fundamental starting point in analyzing the justification for usury ceilings must be the basic American concept of a competitive market operating within a free enterprise system. As a general proposition, based on strongly held and well-developed political and social views, the American economy has long been characterized by the free market operating without government interference, except when clear economic or social justification can be shown for that intervention.

Historically, artificial price controls of whatever character have been rejected as being an unacceptable mechanism for allocating or pricing goods and services. As a form of price control, usury limits fare no better under contemporary analysis.

Two recent examples of government intervention in money matters make it unnecessary to speculate about whether non-market mechanisms are any more desirable in this area than in any other. The first involves attempts to replace the free

market with government restrictions on the amount of interest being paid by financial institutions, commonly referred to as Regulation Q. For about the past fifteen years, government controls on the amount of interest payable to depositors have created an ever-increasing divergence between what the law permitted depository institutions to pay and a fair, market return to consumers. Not surprisingly, the market found ways to avoid these limitations. As described in oversight hearings before this Committee earlier this year, money market mutual funds have filled this gap and now hold about $ 130 billion. Price controls calculated to "help" an industry have contributed significantly to its current problems. There is no reason to believe that government controls on amounts of interest paid to financial institutions rather than by them are any more effective or efficient at meeting their stated objectives.

A second example is provided by the piecemeal efforts -- at both the state and federal levels -- to deregulate price controls on money by lifting or changing some but not all usury ceilings. Under the Depository Institutions Deregulation and Monetary Control Act, for instance, mortgage lending and business and agricultural credit were afforded different treatment from that given to general consumer credit. Can there be any serious doubt but that creditors in low rate environments would seek to make profitable loans in these areas rather than unprofitable loans in areas subject to more severe ceilings? This inevitable channeling of funds -- regardless of the preferences of the consumer as to what he or she wants to use credit for --

is descriptive of credit allocation not by the market but by arbitrary governmental rate ceilings.

Once again, it cannot be overemphasized that usury laws are nothing more than price controls that impose specific limitations on the price (reflected as interest or a time-price differential) paid for a specific commodity (the use of money). As with all such artificial governmental controls, the American experience has indicated that they are simply inefficient and unfair and produce inappropriate social and economic dislocations.

There is clear evidence that these disruptions have been produced by usury laws. An illustrative economic inefficiency is that lenders and other creditors are unable to charge prices for credit services that are commensurate with their costs. Since these entities, in order to survive, must operate at a profit, such unprofitable transactions must be subsidized through rates charged on other transactions. The matrix of usury laws and pricing restrictions creates a series of subsidies and dislocations -- including cash purchasers subsidizing more affluent credit purchasers, and credit card users who use and pay for credit as opposed to convenience users who do not pay for a very valuable payment mechanism. As a result of these controls and restrictions, the cost to some consumers is too low, while that to others is too high.

In addition, the diversion and curtailment of credit can cause economic harm at a more general level. For example, a 1977 study of the Tennessee economy estimated that the state usury ceiling caused an annual loss in output of $150 million and the loss of 7,000 jobs.

Other examples of the substantial and adverse impacts of usury laws on the economy as a whole are shown by the experience of two major banks located in the state of Maryland. During the past 18 months, one bank has reduced its installment credit portfolio by nearly $80,000, a decrease of almost 30%. One result of this dramatic change forced by state usury laws was that 27 positions -- affecting about 20% of the personnel handling this type of loan -- were eliminated.

In the case of a second bank, during the past 15 months in response to the increase in cost of funds and to state usury limitations, the bank reduced its consumer credit portfolio by $200 million. That constitutes a reduction of 25% of the total portfolio previously held by the bank. One of the direct results of this has been a reduction of 115 employees operating in that area, approximately 25% of the total number of employees involved in consumer credit. The impacts are substantial and they are real.

In addition to these economic disruptions, usury laws have given rise to geographical dislocations based on rational business decisions with respect to usury ceilings. As should be expected in a highly mobile society, recent changes in certain states' usury laws have produced positive responses from financial institutions large enough to deal with the substantial capital and set-up costs to move to these more favorable regulatory environments in order to provide services to customers and potential customers.

In the case of my own bank, we made a decision to locate in the state of Delaware in order to operate in a rate climate

that would allow us to offer credit programs to potential customers at rates that were consistent with our costs. As has been reported in the media, our approach is not unique. A number of other institutions facing usury ceilings have simply moved to avoid them.

Among the factors considered by those involved in these activities is the ability to plan for future development and expansion in light of uncertain or shifting state rate decisions. Although temporary relief has been provided in some states including New York, it generally is not permanent and provides little basis for extensive future planning when the law affecting a major pricing issue remains in flux.

In short, the disruptions caused by governmental interference provide clear evidence that the general free market approach that characterizes virtually all other segments of the American economy should apply equally to credit. If, contrary to this general rule, credit is to be afforded unique treatment, there must be a clear justification for the continuation of price controls in the form of usury statutes. As the following discussion will demonstrate, however, no such justification now exists.

2. The Arguments Presented

Three general arguments are used to support usury laws. The first is that there is no effective competition in the credit industry, so that the termination of usury ceilings

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would result in radically high credit costs. The second justification is the fear that consumers are generally unsophisticated in credit matters and, therefore, are unaware of credit costs. This lack of sophistication, reflected by unawareness of credit costs, it is argued, will permit creditors to charge very high rates of interest if usury ceilings are eliminated. A third justification for the continuation of usury ceilings is that the limitation on the availability of credit, which is caused by usury limits, is a good social result since it prevents consumers from "overextension" and saves them from the inevitable economic and social disruptions caused by overextensions, including litigation, foreclosures, bankruptcies and the like.

All of these justifications for interest rate ceilings are based on unsupportable factual premises and none of the justifications has any relationship to contemporary American society.

A. The Market Is Not Monopolistic. There simply is no support for the assertion that the credit industry is monopolistic. The credit market is composed of an enormously large number of sources of credit. The new short-term lending programs being undertaken by credit unions, savings and loan associations and savings banks will cause a significant addition to the supply side of the lending equation. As a general matter, competition is being affected favorably by a developing credit industry. The Federal Reserve Board studied a number of firms and the degree of concentration in 213 Standard Metropolitan Statistical Areas and 233 county markets between 1966

and 1975. The conclusion reached by the Board was that more markets experienced structural changes that enhanced competition than changes that reduced it.

Competition in the credit industry can also be shown by looking at the experience in states with no usury limits or with very high usury limits. In California, where, in effect, banks are not subject to usury limits, there is simply no evidence that creditors are reaping unusually high rates of return. The National Commission on Consumer Finance confirmed earlier studies that actual rates tend to fall below the maximum usury rates when these maximum rate limits were in excess of the effective cost of providing "lendable" funds. Thus, from both a structural point of view and from an historical review of the experience in states not having usury limits, we find substantial evidence to indicate that the credit industry is competitive. Although the current existence of usury limits that are set below market rates creates the current situation where many creditors are charging the same rates, it is hardly fair for those favoring usury limits to employ a principal symptom of these limits, namely the existence of identical rates throughout the industry in a given state, as a reason for the continuation of the limits.

Recent experience in my state of New York confirms the existence of a competitive market. New York has adopted a temporary and limited lifting of interest rates. The early response, as documented by the New York State Banking Department, is that the market is providing consumers with more

credit and that a wide range of interest rates and fees are being charged by lenders. These variations, hardly characteristic of a monopolistic situation, were found to present consumers with alternative choices which can be identified through credit shopping.

Moreover, in analyzing competition, it is important to emphasize the anticompetitive impact of usury laws. The continued existence of usury laws discourages even more competitors from entering the credit market and may, therefore, encourage concentration. It is obvious that potential new entrants have little incentive to compete in the credit market when the rates they can charge are limited by artificial, governmentally imposed ceilings, while many of their costs are dictated by an unregulated free market. That is particularly true since many of these credit programs involve substantial start-up costs which must be recouped before even considering the question of ongoing profitability. In the current economic situation, potential market entrants face a high risk, small gain potential, due, in large part, to the existence of usury restrictions.

The conclusion that usury ceilings deter new entry into the credit market was reconfirmed once more just over a year ago in the final report of the Interagency Task Force on Thrift Institutions. That Task Force, established in the Depository Institutions Deregulation and Monetary Control Act, analyzed the impact of usury laws on the participation of thrifts in more diverse consumer lending markets. It concluded that these

ceilings discourage, if not prevent, diversification. It seems to be of little use to provide institutions with expanded powers if usury limits effectively prevent their use.

Furthermore, in some credit areas usury laws, and efforts at avoiding them, may actually lead to greater market concentration. In the credit card area, for instance, some financial institutions in states with no or very high rate ceilings -- or having the economic resources to move to those states -- are purchasing the portfolios and programs of creditors that are located in low interest ceiling states. The purchasing institutions then market their programs into the low-rate states at rates set by the market that reflect their real costs. One of the results of these activities -- which merely reflect the logical workings of a free market -- is to reduce the number of competitors participating in these programs and, of course, consumers end up paying a market rate. While, of course, that does not suggest the building of a monopoly, it is nonetheless somewhat troublesome from the perspectives both of possible competitive impact and the political and social desirability of local control over these credit activities.

In short, the market is already extremely competitive, and we believe that competition would be enhanced even further if usury laws were set aside.

B. Consumers Have A High Level Of Credit Cost Awareness. The argument that consumers are unaware of credit costs flies directly in the face of extensive private and governmental studies indicating that the literally millions of

dollars spent by the credit industry on Truth in Lending disclosure activity have produced results. One study of bank credit card users found that for every 100 respondents in 1969 who did not know the annual percentage rate, only 50 had a similar response 15 months after the Truth in Lending Act became effective. This level of awareness has continued to grow. In a 1975 study of the awareness of the annual percentage rate in connection with revolving credit, one researcher found a 56.7% awareness rate for the total sample. A 1978 study of California bank cardholders found that almost 80% of the sample knew the annual percentage rate. In a study conducted by the Federal Reserve Board, it was found that, between 1969 and 1977, the awareness of closed-end credit annual percentage rates increased from 14.5% to 54.5%. Awareness of rates for bank credit cards during the same period increased dramatically from 26.6% to 71.3%. Without question, these levels of awareness are adequate to assure rate competition among credit grantors.

C. <u>Consumers Are Not Overextended</u>. The final argument used in support of usury limitations is that such limitations save consumers from overextending themselves. This "noneconomic" argument for the continuation of usury ceilings is really just the current version of the traditional social and religious view of interest and lending itself as being evil. The argument that consumers have insatiable credit appetites that are being held in check by usury limitations is not supported by any empirical data. Indeed, this argument has been

refuted by studies that show that the growth of credit outstandings is basically similar to the rate of inflation. The fact that consumers are not "overborrowing" has also been shown by private studies that have used a variety of income statement and balance sheet approaches.

In summary, Mr. Chairman, the three bases cited for the continuation of usury laws are simply without foundation in today's society. As in other attempts at placing economic controls on our economy, governmental price controls do not produce benefits to the market or those it serves.

USURY ACTUALLY HARMS THE CONSUMERS IT IS SAID TO HELP

Not only do these artificial price controls fail to produce positive benefits, but they actually damage both the economy and the very consumers they are said to protect. For example, usury laws severely limit the availability of credit when the market rate for money exceeds the maximum rate set by the states. Testimony presented before the full Senate Banking Committee earlier this year demonstrates this problem.

A banker from Massachusetts testified that the maximum rate obtainable under Massachusetts law for open-end credit plans is 18% on the first $500 of the finance charge balance and 12% on the finance charge balance over $500. That works out to an effective rate of return of 12.33% for a customer with a $9,000 debt. Obviously, this rate of return is not

profitable given today's costs of obtaining money (the cost of funds for that banker's consumer lending area was 17.53% for the first quarter of 1981).

The problem is not that of one bank alone. Recent studies of major banks in Massachusetts provided vivid evidence of the problems produced by usury laws. Two consecutive studies of the bank card experience in Massachusetts were conducted by the highly respected firm of Peat, Marwick, Mitchell & Co. The studies analyzed bank credit card operations in 1979, before the dramatic increase in cost of funds took place, and again in 1980. While the 1979 study revealed heavy losses by banks in their credit card operations, it is abundantly clear that the rising cost of funds has been the chief cause of even more unprofitable results in 1980.

The studies revealed that the banks surveyed in 1979 lost $13.74 on each credit card account. By 1980, that amount had increased to $19.67. On a transaction basis, each time a consumer used his or her bank credit card in 1979, the bank lost 81 cents. In 1980, the banks lost $1.23 on each credit card transaction. In 1979, the seven banks surveyed suffered a net before tax loss of $15 million on their credit card operations. The 1980 figures showed a total loss of $20.5 million, despite the imposition of membership fees by six of the seven banks surveyed which brought in $3.8 million in new revenues. The cost of funds needed to support the outstanding balances rose from $36 million in 1979 to $45.4 million in 1980. Thus,

the overall loss was not due to unique circumstances faced by any one of the banks surveyed. In fact, each of the banks surveyed has a loss on its bank credit card program.

Given the cost calculations reflected in these studies, in order for the banks to break even, their cost of funds would have had to be 6.68 percent in 1979, and 7.2 percent in 1980. That point -- which does not include any profit or return -- reflects cost of funds levels that have not been available for some time.

Due to the value of these programs to their customers and to the bank's overall service package, many banks have continued to offer these programs. However, as these figures demonstrate, this simply cannot continue indefinitely. The losses being sustained in this area are obviously being passed on to consumers of other credit and noncredit bank services, creating yet another economic subsidy. Quite clearly -- in view of the current cost of funds and the governmentally-limited prices on credit services -- many banks facing this situation will have to reduce credit availability and will ultimately be forced to terminate this form of open-end credit plan. (Parenthetically, it is particularly troubling to our industry that the customer who obtains a 12.33% loan from that Massachusetts banker, a rate mandated by state law, can today earn about 16% in a Merrill Lynch cash management account, which has a plastic card access feature.)

The reduction in available credit is not limited to open-end credit. As a direct result of usury limitations, one major

Pennsylvania bank has reduced installment loans by almost 37% between 1978 and 1980. During the same period, by the way, that bank had to respond to usury limits by reducing the number of new open-end accounts by almost 50%.

The first consumers injured by the reduction in the supply of credit, which is caused by usury limitations, are the less affluent. Since the economic return of creditors is in large measure based on the risks of repayment, any reduction in the supply of money for lending will cause creditors to lower their risk factors for the funds actually lent. Accordingly, those consumers with lower credit ratings, lower incomes and a higher incidence of unemployment will almost certainly be the first to be excluded from the credit pool. Absent a conclusion that deprivation is the equivalent of protection (an argument described and refuted earlier in our testimony), the end result is that those who are the intended beneficiaries of usury laws are, in fact, the consumers most adversely affected by them.

FEDERAL RELIEF IS APPROPRIATE

For all of the reasons briefly set out above, the Association believes that the time for usury relief is now and that it is appropriate -- in fact, essential -- that it be provided at the federal level. We respectfully urge that Congress take immediate action on this urgent problem.

We recognize that our suggested solution for this problem, namely the federal preemption of state usury laws, will cause

concern to those who favor the continuation of the prerogatives of state government. Although most usury laws have been enacted at the state level, there are many reasons for suggesting that federal relief is both appropriate and necessary. We think that the following factors particularly recommend Congressional action:

1. The continuation of usury limitations has an important adverse impact on the national economy.

2. Congress has not abandoned this area of law to the states but rather has maintained an active involvement in the field. As a particularly important example, the cost of the funds used for lending is, in large measure, the result of federal activity.

3. The need for immediate uniform relief can only be met by Congress.

1. <u>The Negative Impact On The National Economy</u>

As indicated earlier in our testimony, the most predictable result produced by state credit cost ceilings that are below market rates is the unavailability of credit. If the action of the legislature of any given state would injure only the residents of that state, then we would see some merit in treating the problem at the state level. It is impossible, however, to limit the damage done by usury limits to the geographical boundaries of any state.

The obvious results of artificially set interest limits are homes unbuilt, automobiles not purchased, home improvements

delayed, vacations forgotten and education plans revised. In a very real sense, the persons injured by the usury limits of New York, for example, are the workers and stockholders of industries whose demand is cut by the reduction in credit availability. Without question, the small business operator in Texas, the ski area owner in Utah, the maker of aluminum siding in Indiana, the auto worker in Detroit, the farmer in Illinois and the airline pilot in Hartford can all be injured by the interest rate decisions made by the state legislature of New York. These problems mean that even states that have acted to change their rate ceilings are directly affected by the usury problems of other states. To fail to see interest ceilings as a federal problem is to lose touch with the reality that credit flows through and directly affects a national economic system that operates without regard to political boundaries.

In addition to these goods and services "export" problems, the citizens of all states are affected by the usury laws of other states due to the relationship between credit costs and the cash prices of various goods and services. When a national creditor is forced to subsidize credit costs in some part of the country, those costs inevitably will become part of the cost of the goods being sold. Those higher costs will be paid by all consumers, not just those in the state that is experiencing the usury rate problem.

It is also important to recognize, both in regard to these national subsidies and to the shape of the affected industry, that the credit industry is itself fast becoming a national

industry. The nationwide marketing of bank credit cards, the national presence of General Motors Acceptance Corporation, Sears, and J.C. Penney, and the daily presence of American Express advertisements all suggest that consumer credit is a national resource. It is simply unrealistic at this stage to suggest that creditors who sell their product (the availability of funds) on a nationwide basis must stay alert to and carefully follow the patchwork of state usury laws that govern consumer credit transactions. It seems inconceivable that anyone would advocate that states should be allowed to impose price controls on other commodities that flow in interstate commerce.

2. Federal Participation In Usury Has Been Substantial And Longstanding.

A. Federal Involvement Has Extensive Precedent. Although there has been substantial state involvement in the establishment and maintenance of usury ceilings, it is simply inaccurate to view usury as a state prerogative that has been untouched by federal law. The federal government has been involved in usury matters for many years. Under existing federal law, state usury laws for certain types of credit transactions have been totally displaced and state usury laws relating to all types of transactions have been preempted (at least to some extent) for federally chartered and federally insured financial institutions.

For almost half a century, national banks have had a permissive maximum usury ceiling in connection with all loans. In 1933, Congress established a permitted interest rate ceiling for national banks that was tied to the Federal Reserve Board's discount rate. State usury laws that were below the established level of 1% over the prevailing discount rate were preempted.

The recognition of usury as a national concern has also been reflected in more recent legislative activity. In response to specific problems resulting from 10% usury limits (imposed by state constitutions in Arkansas and Tennessee and by statute in Montana), Congress provided for limited federal preemption for the period from October 29, 1974 to July 1, 1977. [Act of October 29, 1974, Pub. L., No. 93-501, 88 Stat. 1557 (1973).] Similar relief as to specific types of credit was sought and obtained in 1979, as costs of funds increased dramatically. The interim legislation affecting mortgage loans and large business and agricultural loans was adopted on December 28, 1979. [Act of December 28, 1979, Pub. L., No. 96-161 (1979).]

Shortly after this interim legislation was adopted, Congress passed a more durable measure that preempted usury limits at least partially in three areas. [Act of March 31, 1980, Pub. L., No. 96-221 (1980).] This legislation, part of the Depository Institutions Deregulation and Monetary Control Act, preempts state usury laws that limit the rate or amount of interest, discount points and finance charges that may be charged in connection with real estate mortgages and -- if the contract

contains specified provisions -- the financing of manufactured housing, including mobile homes. States may, of course, reimpose their own usury ceilings within a three-year period and several have already done so. It also preempts for three years state laws in connection with business and agricultural loans of more than $25,000 (an amount that was later reduced to $1,000). This preemption remains subject to an overall rate limitation of 5% over the Federal Reserve's discount rate, including any surchage then in effect. Finally, the 1980 legislation provides for the preemption of state usury laws for all loans made by state-chartered, federally insured institutions, subject to a ceiling of 1% above the Federal Reserve's discount rate (placing them on a par with national banks).

These federal preemption provisions give strong evidence, not only of federal involvement in the usury area, but also of the fact that Congressional scrutiny of state usury ceilings has resulted in their being overridden. Thus, the action our Association recommends has solid Congressional precedent.

B. Other Federal Regulatory Actions Have Affected The Impact Of Usury Laws. In addition to its direct participation in setting or totally lifting usury ceilings, the federal government has played a substantial role in those factors that magnify the economic and social obsolescence of usury limits.

During the past decade, Congress has passed a virtual avalanche of new laws affecting creditors, many of which are implemented through complex regulations. These federal laws,

in most cases preempting state laws, reflected federal decisions about the need for and appropriate level of consumer protection.

This extensive participation of Congress in the credit industry has resulted in a direct shifting of responsibilities and costs between consumers and creditors, and to varying degrees has imposed substantial costs on creditors. A long list of consumer credit provisons can be cited, including:

Truth in Lending Act
Truth in Lending Simplification and Reform Act
Fair Credit Reporting Act
Fair Credit Billing Act
Equal Credit Opportunity Act
Fair Debt Collection Practices Act
Electronic Fund Transfer Act
Home Mortgage Disclosure Act
Real Estate Settlement Procedures Act
Fair Housing Act
Flood Disaster Protection Act of 1973
Community Reinvestment Act
Interstate Land Sales Full Disclosure Act
Right to Financial Privacy Act of 1978

Each of the foregoing acts has imposed certain duties and obligations on creditors. In an attempt to enhance the position and rights of consumers, all of these changes have involved at least some costs. For example, one Federal Reserve study

estimated that the cost of implementing Regulation B, promulgated under the Equal Credit Opportunity Act, would cost creditors $294 million.

Although reasonable minds may differ as to the magnitude of those costs, it seems intuitively clear that consumer credit regulation has added to the cost of credit. Indeed, in many instances the additional costs have been acknowledged by the proponents, but the Congressional judgment has been that the increased protections to consumers are worth the resulting increase in costs.

In short, the advent of a wide array of federal statutory and regulatory duties, limitations and prohibitions has created costs that creditors are often unable to recover through higher interest prices because those prices are limited by state usury laws.

C. <u>The Federal Role In Regulating -- And Now Deregulating -- The Cost Of Funds Has Directly Affected Credit Costs</u>. An additional, and very important, factor in considering the federal role in the usury law question involves the impending deregulation of a major portion of a bank creditor's cost of doing business, the cost of funds. Since the early 1930s, the rates paid by financial institutions on deposits have been regulated by the federal government. These rate limits have had their principal impact since 1966, when these ceilings had the effect of differentiating maximum permissible rates among different types of depository institutions and of artificially reducing the cost of funds to bank creditors.

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The 6-year phase out of Regulation Q and the introduction of NOW accounts as a national product were both provided in the 1980 Deregulation Act. Pursuant to that statute, just last week the Depository Institutions Deregulation Committee published a final regulation that spells out in timetable fashion the demise of remaining rate limits on deposits. The regulations, which will be effective August 1, 1981, deregulate interest rate ceilings according to the maturity of the deposit. Under the regulation, interest rate ceilings on various maturities will be eliminated in accordance with a fixed deregulation schedule that will first deregulate longer term time deposits on August 1, 1981 and will remove all deposit rate ceilings by August 1, 1985. Clearly, the increased rates that banks will pay to their depositors will further increase their cost of funds.

This action removes the final vestige of the federal government's longstanding role of reducing costs of funds for deposit-taking creditors. Thus, the federal government, particularly by actions taken in the 1930s, 1980 and this year, has had a significant impact on the cost of funds used for credit extensions.

The federal government plays a unique and fundamental role in the cost of lending transactions. This cost side is directly related to the interest prices that must be charged on loans. It is simply illogical to ignore this substantial federal involvement when considering the pricing side that now remains subject to state law.

D. Conclusion: The Federal Role In Usury Has Been Substantial. The response to the argument that usury laws were and remain the appropriate and exclusive province of the state is that this suggestion is simply factually inaccurate. Both direct and indirect involvement of the federal government have existed for almost half a century, a trend that has accelerated rapidly in the past decade. In the limited displacement of state usury ceilings, the imposition of new responsibilities that produce costs, and the participation in setting -- and then deregulating -- maximum deposit rates that affect directly the costs involved in lending, the federal presence in the usury area is established and apparent. It is neither improper nor inappropriate for the federal government to recognize the effects of its cost-generating activities by also dealing with the pricing side of the equation it has devised.

3. Timely, Uniform Relief Is Afforded Only At The Federal Level.

Moreover, Mr. Chairman, only federal legislation is capable of producing the rapid response needed to provide relief from archaic state usury laws. The alternative is a gradual series of state legislative pronouncements that might be adopted and, even then, only after extended discussion and debate that doubtless will produce a broad array of different types of provisions. Insofar as there has been a state response, in many cases only temporary relief has been provided. In my own state of New York, the legislation expires in 1983 and loans under \$2.5 million could once again be subject to usury ceilings. Multiple diverse rules, many only of brief duration, adopted

over a span of years simply will not respond to the immediate needs presented by the dynamic market forces that operate at a national level.

In view of today's national credit market, a state-by-state piecemeal approach simply will not work. Multi-state creditors cannot operate efficiently being subject to a constantly changing patchwork of rate ceilings. Planning efforts have become meaningless since predicting the duration and nature of the responses by a large number of legislative bodies is impossible. Perhaps most important, is the growing number of states that have rejected usury ceilings provide increased opportunities for financial institutions to offer credit at market rates. This means that as a practical matter even some consumers in low rate states who want credit will often be able to obtain it from out-of-state sources at market rates. Thus, insofar as justification for continued state action is based on "protecting" consumers from market rates, that objective has been thwarted by the inevitable workings of the free market.

In addition, history has shown that attempts to provide a uniform and reasonable usury ceiling at the state level have fallen short. In the late 1960s and again in the early 1970s, the Uniform Consumer Credit Code was proposed by the National Conference of Commissioners on Uniform State Laws. This comprehensive legislative effort operated from the premise that a competitive market -- assured by very few barriers to market entry for potential creditors -- should be allowed to operate within usury ceilings that, at the time of their adoption, were

very high. Essentially, the UCCC provided interest rate ceilings of 36% for loans up to $300 or less, 21% for loans of $300 to $1,000, 15% for loans greater than $1,000 or an alternative flat rate of 18%. Yet, in response to this massive effort, only nine states* have adopted the UCCC in some form -- fully or partially -- since it was first proposed in 1969. Both inertia and political pressures at the state level appear to explain the retention of usury ceilings or the tendency to provide only limited and somewhat arbitrary exceptions.

In short, the spped and consistency necessary to address the usury ceiling problem simply are not available at the state level. Federal action is the only realistic avenue for usury relief.

PENDING LEGISLATION

Mr. Chairman, we believe that legislation now before this Subcommittee would provide the necessary relief. On June 22, 1981, Senator Lugar of Indiana introduced legislation cosponsored by Senators Garn, Proximire and D'Amato that addresses in a straightforward manner the question of governmental price controls on

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*Various sources cite different figures respecting the number of states that have "adopted" the UCCC, depending on the extent to which the model code was followed. These figures generally vary from six to nine states.

the price of money. We earnestly believe that the Credit Deregulation and Availability Act will do much to alleviate the problems that we have discussed today.

This important legislation would provide relief in two areas. The first involves consumer credit transactions and the second relates to business and agricultural credit. We would like to comment on both of these aspects of S. 1406.

The basic thrust of the consumer credit provisions is to release the free market from artificial restraints, permitting the highly competitive consumer credit marketplace to establish rates. This allows creditors to make credit available to consumers who want it at a price based on the costs involved. The bill permits the free market to establish both the shape and the level of the charges being assessed. As demonstrated by the New York experience noted above this allows creditors to make credit available while consumers are protected from unreasonably high rates by free market mechanisms. We consider this to be perhaps the most important feature of the bill.

The absence of an arbitrary "cap"and the consequent working of the free market is the only way of assuring the reasonable availability of credit. As Dr. Johnson testified last week before this Subcommittee, any rate restriction that serves a purpose has the impact of denying credit availability. The diversity of credit transactions involved simply cannot be covered by a single rate. The risk involved, the dollar amount, and the term of the transaction are only a few of the multiple factors that make one rate inappropriate.

Moreover, setting a specific rate involves either looking at current market rates or making predictions about future rates. Neither alternative is desirable. Seizing on current rates generally involves setting a static limit based on today's situation on a dynamic commodity. That approach seems certain to assure a perpetual series of rate changes through attempts to keep up with market changes -- a process unlikely to be responsive in a timely way to market shifts. Predicting future rates seems equally impossible. If nothing else, the past two years has served to remind all of us that the market does not always perform predictably.

By the same token, attempts at seeking an appropriate index have consistently failed. In our experience there is no index that reflects accurately the multitude of factors that must be included in pricing credit services. Indexes tied to some indication of money costs ignore operating and other non-money expenses. Moreover, there is no index that will consistently provide a valid reflection of even the cost of funds. We have analyzed virtually every known index and none will give an accurate indication of the market cost of funds as those costs relate to both long and short term transactions.

Perhaps the best example of the difficulties involved in selecting an index has been the persistent suggestion that we look to the Federal Reserve Board's discount rate. The Association would respectfully suggest that the discount rate is simply an inappropriate measure for setting interest rate

levels. The discount rate is an administered rate on essentially short term funds, calculated primarily on the basis of then-existing monetary policy. It bears virtually no direct relationship to the creditor's cost of funds, let alone the other costs associated with lending. Perhaps more important, this rate may be altered for reasons quite separate and apart from anything having to do with the cost of money or any other related costs. As Vice Chairman Schultz of the Federal Reserve Board testified last year before the House Committee on Small Business, the use of the Federal Reserve discount rate is an inappropriate measure to use in attempting to set rate levels.

In light of the economic problems caused by price controls and the availability of a competitive free market as a mechanism to set the price of credit, it is difficult to justify the need to set any ceiling, whether fixed or indexed. As described earlier, the traditional justifications no longer support the continuation of usury ceilings. The only additional reason cited in favor of usury ceilings is the suggestion that they somehow are related to and deter loan shark activity. There seems to be little evidence to that effect.

As an initial matter, it seems highly unlikely that loan sharks are going to be greatly influenced by any form of legal constraints. We have no reason to believe that they now follow usury laws, suggesting strongly that only legitimate credit grantors are truly hurt by usury laws.

Similarly, the use of these laws as a mechanism to prosecute loan sharks is neither realistic nor necessary. Although

we do not have statistical data, the observation of Association members is that few if any usury violations are actually prosecuted. Furthermore, these laws are not needed as a mechanism to prosecute these offenders. Numerous state and federal laws — including Truth in Lending — carry criminal penalties for their violation. It is difficult to imagine a loan shark making Truth in Lending disclosures or meeting the duties imposed by the array of other state and federal credit statutes.

Finally, if the activity giving rise to concern is truly loansharking, federal law currently proscribes that activity and imposes substantial penalties on those who violate the law.

In short, the only effective method of preventing loansharking is to allow access to legitimate credit markets. This can be accomplished only through permitting the free market to operate, as would be the case under S. 1406.

Thus Senator Lugar's bill properly allows the market to set rates. While relieving price controls, S. 1406 would leave in place the state network of consumer protection provisions. Only state laws that deal specifically with rates or charges would be displaced. This permits the states to respond to specific difficulties that they may encounter in dealing with abusive credit practices unique to their states while at the same time permitting creditors whose costs are largely influenced by federal action to recoup those costs. In addition, by preserving the right of the states to displace the federal preemption, their prerogatives are respected.

Some concern was raised by one witness at last week's hearing before this Subcommittee about section 533(c) of S. 1406, which permits the states to fashion less than a complete displacement of the federal statute. While the Associaton does not have a strongly held view about this provision, it should be noted that the subsection does nothing more than make the states aware of an additional alternative in dealing with the usury question. Quite clearly, since the states can reject the federal provisions totally, they could do so and add back only some of the federal provisions. The practical result remains the same. It should also be noted that a similar provision appears in H.R. 2501 introduced by Congressman John LaFalce of New York, presumably also in an attempt to alert the states to this middle ground alternative.

We believe that S. 1406 as written provides a comprehensive and desperately needed response to the growing usury problem being faced today by consumer lenders. As has already been pointed out before this Subcommittee, the temporary relief recently granted to business and housing credit has had a negative discriminatory impact on consumers who seek credit for other purposes. Those consumers should be permitted to compete in the market with other credit consumers, a result being blocked by usury laws.

Finally, the Association strongly supports the amendments in S. 1406 to the existing business and agricultural credit exemption. The changes reflected in Senator Lugar's bill are totally appropriate, given the desirability of free market operation.

In addition to the bill introduced by Senator Lugar, there is currently pending before this Committee a bill introduced by Senator Bumpers and cosponsored by Senator Pryor, S. 963. This bill is designed to provide for nonfederally-regulated creditors a permissive usury ceiling similar to that afforded federally-regulated lenders in Part C of Title V of the Depository Institutions Deregulation and Monetary Control Act.

At the outset we should note that although Senator Bumpers indicated in his introductory remarks that the legislation would resolve an "inequitable situation" created by the Deregulation Act, his bill in its current form would permit non-regulated creditors to have a higher ceiling than that provided to regulated creditors. This results because the ceiling provided by S. 963 is tied to the Federal Reserve Board's discount rate plus any applicable surcharges. The general exemption providing an alternative ceiling for federally-regulated creditors, however, extends only to 1% over the Federal Reserve Board's discount rate without including any surcharges that might be in effect.

We are pleased by the attention given by Senators Bumpers and Pryor to this problem and commend their efforts. In addition, we agree fully with Senator Bumpers' statement to the effect that usury laws have created disruptions and problems in a number of areas in the economy including the automobile industry.

While we commend the thrust behind S. 963, we believe that it fails to deal with the larger problem which, as outlined

above, relates to the very way in which our free market economy operates. We would submit that the answer is not to simply produce another ceiling artificially set by governmental action -- and indeed a ceiling that is already of questionable benefit given current market rates. The obsolescence of this "ceiling" even before it has been adopted strongly suggests the futility of trying to allow nonmarket forces to set the rate level. The problems inherent in embracing yet another ceiling -- and one that is set at some 5% below the prevailing prime rate -- indicate that this measure simply does not meet the larger problem of usury, either in Arkansas or elsewhere.

CONCLUSION

In conclusion, Mr. Chairman, usury relief is essential to our industry. As in other segments of our economy, the imposition of arbitrary price controls -- by whatever level of government -- is simply inconsistent with the proper and efficient operation of a free market economy. Congress recently reaffirmed this basic proposition once more when it provided for the end of the enabling legislation that permitted President Carter's ill-fated credit control program of over a year ago. It should similarly recognize that the inappropriateness of these artificial price restrictions is not limited to the federal level, particularly in view of the national credit market in which consumer lenders operate today.

The Association respectfully urges early and favorable action on S. 1406 which would provide essential relief in this most important area. Thank you.

Senator LUGAR. Thank you very much, Mr. Hammer.

The Chair now calls upon Charles Russell.

STATEMENT OF CHARLES T. RUSSELL, PRESIDENT, VISA USA

Mr. RUSSELL. Thank you, Mr. Chairman.

I am Chuck Russell, president of VISA USA, and we are pleased to have the opportunity to appear before you here this morning.

By way of background, VISA USA is a nonstock membership corporation which administers the VISA card program within the United States. We are, in essence, a franchise of the VISA cards and we also provide a telecommunications network so the banks can communicate with one another and pass the information back through the proper sources.

[Complete statement follows:]

STATEMENT OF VISA U.S.A. INC.

Visa U.S.A. Inc. ("Visa") is a non-stock membership corporation, incorporated under the laws of the state of Delaware, which administers the Visa Card Program within the United States. The membership of the corporation is comprised of approximately 12,000 commercial banks, savings banks, savings and loan associations, and credit unions which participate in the Visa Program. As of the end of 1980, the Visa "Blue, White & Gold" card was held by approximately 64,500,000 individuals and accepted at 1,800,000 merchant outlets and 42,000 member offices throughout the country. For the year 1980, total dollar volume of the Visa system in the United States exceeded $28 billion.

Through Visa membership in Visa International Service Association, Visa's members also participate in the worldwide Visa system. Internationally, the Visa system is comprised of more than 12,500 member institutions. Worldwide, the Visa card is held by more than 89,000,000 cardholders and accepted at more than 3,000,000 merchant locations. For the year 1980,

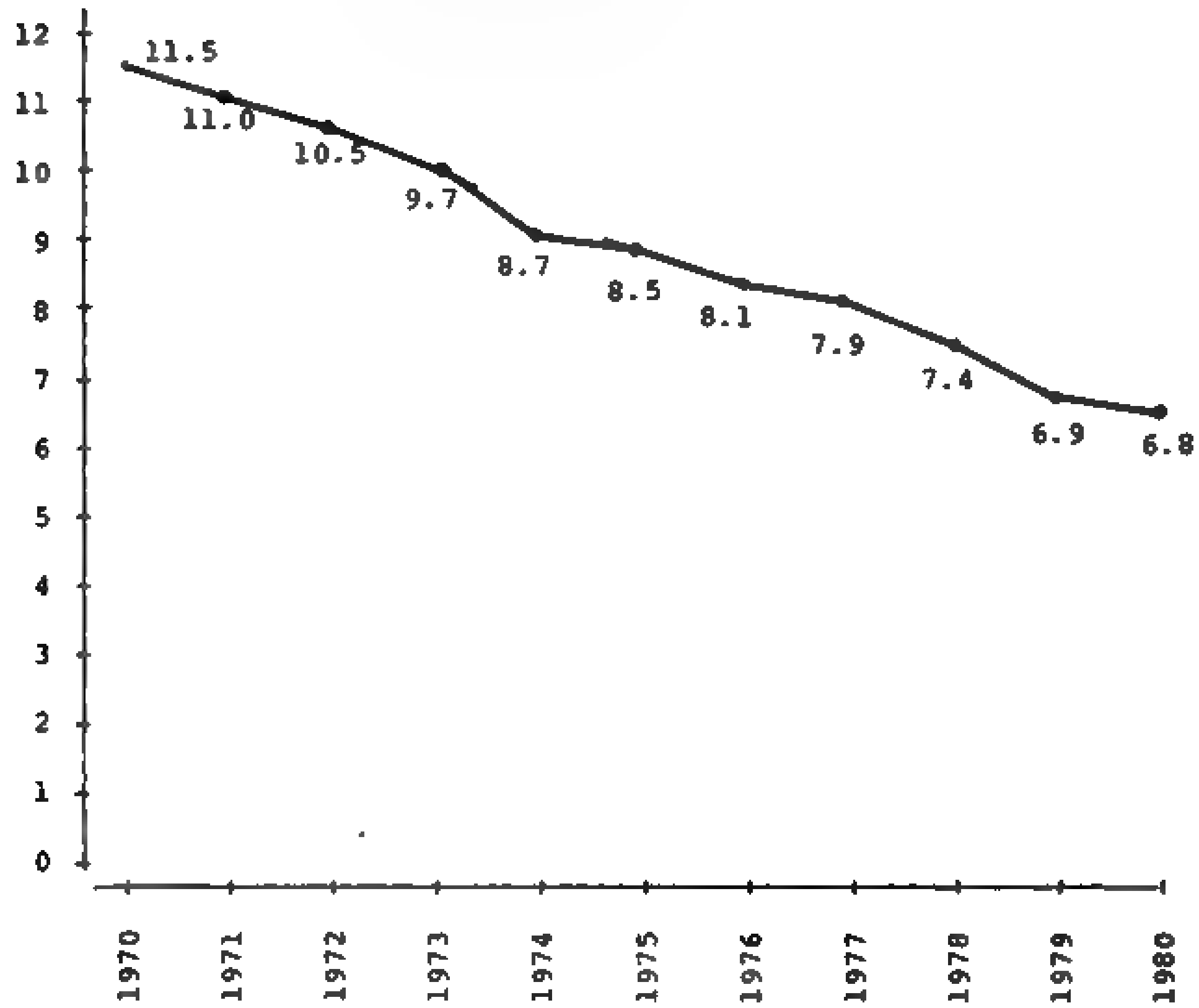
the dollars volume of the worldwide system exceeded $43 billion.

Visa strongly supports enactment of S. 1406. The recent level of interest rates is simply incompatible with the antiquated usury ceilings applicable to consumer loans in most states. By preempting state usury ceilings, S. 1406 would resolve this problem. The usury laws in many states also have prevented financial institutions from charging periodic or transaction fees for the convenience payment use of the credit cards which they issue. S. 1406 also would resolve this inequity. Visa believes, however, that S. 963 is inadequate to accomplish successfully either of these results.

During the early years of the Visa Bank Card Program, due to heavy start-up costs and the relatively low volume of card use in relation to fixed costs, Visa members incurred net losses or accomplished only marginal profitability from their participation in the Visa Program. The subsequent adoption of a variety of operating efficiencies, primarily accomplished by increased use of electronic technology, significantly reduced operating expenses and

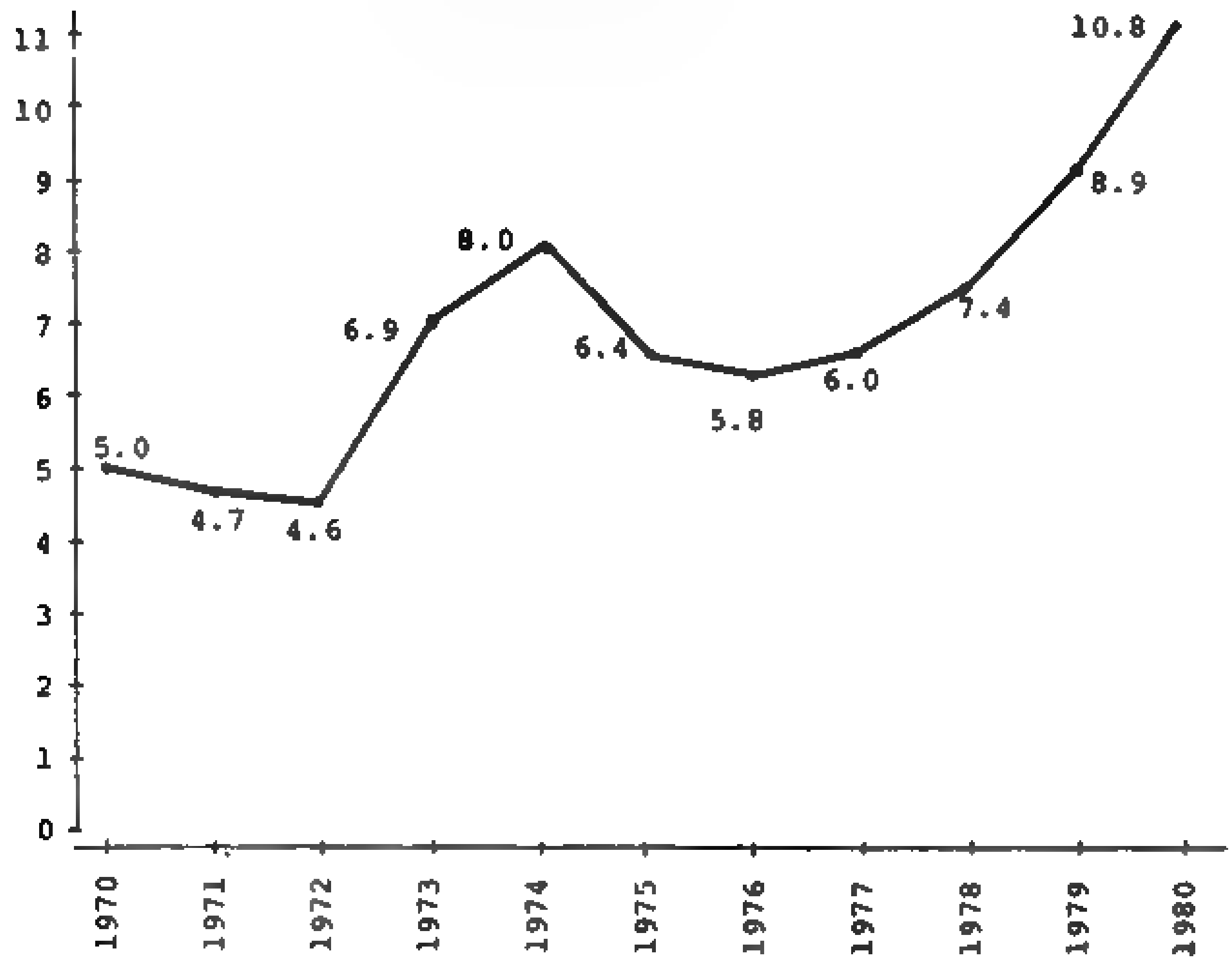
overhead, enabling members to achieve reasonable profitability. Between 1970 and 1980, operating expense and overhead as a percentage of average outstanding balances dropped from 11.5 percent to 6.8 percent.

OPERATING EXPENSE AND OVERHEAD
AS A PERCENTAGE OF
AVERAGE OUTSTANDING BALANCES



During this same time period, however, the cost of funds to Visa members to support outstanding balances, expressed as a percentage of average outstanding balances, more than doubled -- from 5.0 percent to 10.8 percent.

COST OF FUNDS
AS A PERCENTAGE OF
AVERAGE OUTSTANDING BALANCES



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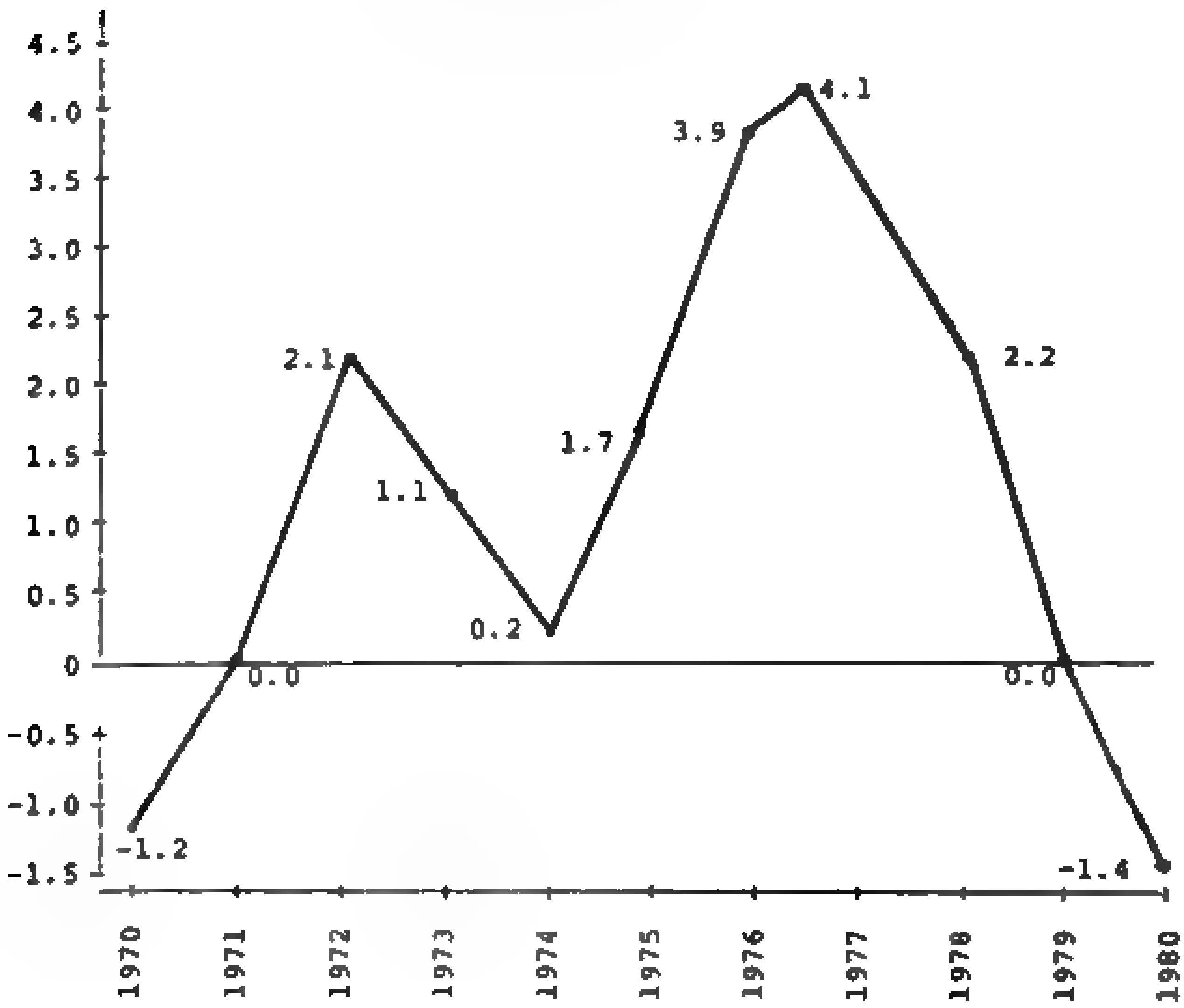
Thus, despite the operating efficiencies which have been accomplished over the last decade, Visa members experienced a net loss from Visa Program operations in 1980 for the first time since 1970.

NET INCOME AFTER ALL EXPENSES
AS A PERCENTAGE OF
AVERAGE OUTSTANDING BALANCES



State usury laws create two principal barriers which prevented Visa members from being able to avoid losing money in the face of the escalating cost of funds in 1980. The inevitably slow pace of state legislative action has left in effect in nearly all states usury ceilings which are anachronistically low in light of the credit conditions created by market forces and government regulatory policy in recent years. Far more importantly, however, the usury laws as worded or construed in many states have prevented Visa card issuers in those states from charging any fee to cardholders for the convenience payment benefit which they derive from holding a Visa card.

A Visa card provides to every cardholder two distinct services. First, it is a payment device which enables cardholders easily and conveniently to make payments for goods and services at more than 3,000,000 merchant locations throughout the world. Second, the card makes available a line of credit. In the event that the line of credit is activated, the cardholder incurs a finance charge during the time required to pay off the credit balance in installments.

The convenience payment feature is made possible by agreements between Visa members and participating merchants which uniformly require the merchant to honor not only those cards issued by the member with whom the merchant has contracted, but also any other validly issued Visa card which may be presented to the merchant as payment for goods and services. It is this assurance that a merchant, wherever located, will honor all validly issued cards, regardless of the financial institution which issued it, that constitutes the basis of a national card system. It is this feature which enables the use, for example, of a card issued to a resident of California at a participating merchant establishment located in New York.

The two basic features of a Visa card are distinctly separate. Many cardholders use their cards primarily or exclusively for the convenience payment feature, routinely pay their card balances within the initial grace period, and rarely or never incur finance charges by electing to postpone payment and to use the line of credit also made available to them by the card.

As a result, 50 percent of Visa's annual dollar volume is paid within the free period and generates no finance charge. Those cardholders who do activate their line of credit and carry credit balances typically do not borrow up to their credit limit and then leave their cards dormant, but carry a fluctuating credit balance and continue also to use their cards for convenience payment purposes.

Historically, consumers have been charged fees for the use of other payment devices and cash substitutes. Most banks traditionally have charged either monthly fees or transaction fees to users of checking accounts; holders of travel and entertainment cards which do not access lines of credit have been charged annual fees; users of travelers' checks have paid purchase fees for the checks. However, the usury laws in many states are expressly worded or have been so construed as to prevent financial institutions which issue cards in those states from charging any fee for the benefit which cardholders receive from being able to use their cards as a convenience payment device.

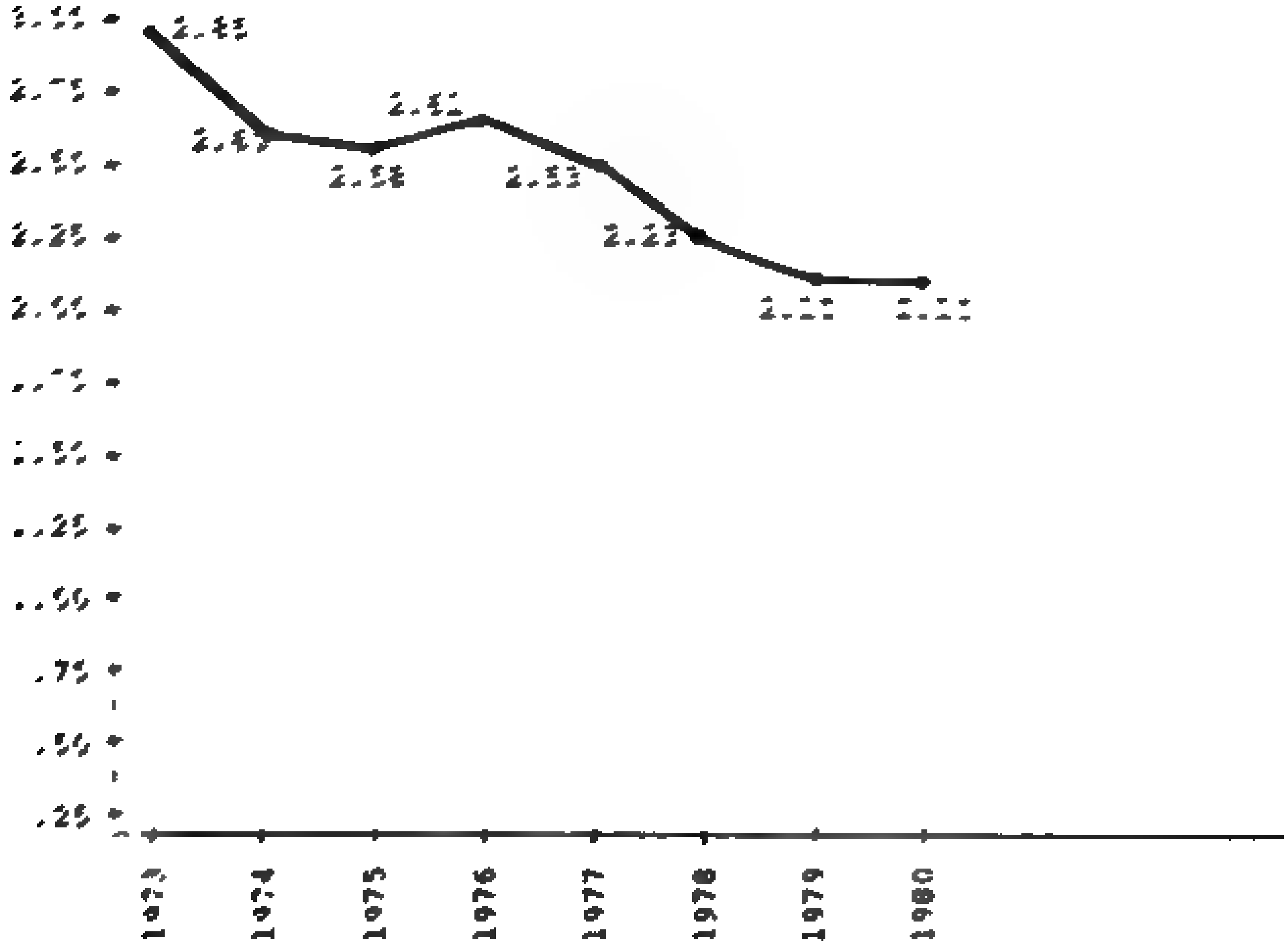
because the cards also access a line of credit, the law in these states has been construed to require that any fee for the use of the card must be regarded as part of the "finance charge" in determining whether total finance charges on extensions of credit accessed by use of the card exceed the amount allowed under the state usury law.

The interpretation of a periodic or transaction fee to be part of the finance charge for card extensions of credit simply ignores the distinctly separate convenience payment function which the card also serves. This function is not only a valuable benefit to cardholders, but an expensive one for the Visa system to supply. Member costs and expenses associated with convenience payment transactions are incurred regardless of whether the cardholder pays off the credit balance immediately and thus avoids paying finance charges. The costs to Visa members include the cost of funds borrowed to pay merchants. Members are obligated to pay merchants immediately upon deposit of a sales draft by the merchant. Until the cardholder pays for that sales draft, the Visa member which issued the card bears the cost of

the borrowed funds. On the average, the Visa member will have to bear that cost of funds for 33 days.

Since 50 percent of total Visa card volume is paid off during the free period and generates no income from cardholders, substantial losses result from those cards which are used exclusively or primarily as convenience payment devices. During 1980 net income from merchant discount fees on convenience user transactions equalled only one-third of the total costs and expenses generated by convenience user transactions. Moreover, competitive pressures in recent years have been pushing the merchant discount fees steadily downward from a high of 2.85 percent in 1973 to a low of 2.10 percent during the last two years -- a drop of more than 25 percent.

SYSTEMWIDE AVERAGE MERCHANT DISCOUNT RATE



The convenience transaction costs and expenses not covered by merchant discount income have to be paid for by periodic and transaction fees or underwritten by income from other sources. The burden of underwriting the convenience users of cards falls disproportionately

on lower income cardholders who traditionally use the credit feature of their cash and thus incur a finance charge. This burden is also borne by small financial institutions which are also most adversely affected by high interest rate trends. The most restrictive state usury laws are generally found where unit banking and small credit unions are most prevalent. Savings and loans, mutual savings banks and credit unions have only recently entered the card business and either are still in the process of absorbing heavy start-up costs or now will be deterred from ever offering this service to their customers.

It is the largest financial institutions which not only already have absorbed initial start-up costs, but can afford to relocate their card operations in states other than their home state in order to take advantage of favorable state usury laws. Because these cards have been held by the courts to be governed by the law of the state in which the card is issued, state usury laws restrict only card issuers located within the state by issuers located elsewhere. Thus, cards can be and are issued on a nationwide basis from a single location.

The largest issuers can afford to move their card operations because the additional revenue from periodic or transaction fees more than offsets the cost of the move. For example, of the 1,500 Visa members which issue Visa cards in the United States, 20 hold 50 percent of the 64,500,000 Visa accounts. For institutions with such large numbers of cardholders, it is economically feasible to relocate bank card operations in states which permit periodic or transaction fees. For smaller institutions, unit banks, and savings and loans with a small number of cardholders, a relocation of card operations would be uneconomical and in many instances would be prohibited by legal barriers. Thus, absent prompt action to establish a uniform policy enabling card issuers in all states to charge a reasonable fee for the convenience payment feature, the small local card issuers soon will be driven out of the business.

The adverse competitive effect on small card issuers of prohibitions on periodic or transaction fees will be greatly increased this fall when Visa introduces

its new premium card. In addition to the features already offered by the existing Visa card, the new premium card will offer personal check cashing privileges at selected locations, access to automatic teller machines operated by Visa members, emergency cash disbursement by participating hotels, guaranteed hotel reservations, travel insurance services, access to money market fund accounts, an emergency trouble and information service, and possible additional features still being negotiated.

The additional features to be offered by the premium card necessarily will make it a much more expensive service for Visa members to offer. In order for members to break even on their premium card accounts, they not only will have to charge a fee for the card, but will have to charge a higher fee than is now common for Visa cards in those states which permit a fee to be charged. However, because the premium card -- like the present Visa card -- will access a line of credit, it will be subject to the same usury law restrictions on periodic and transaction fees. Thus,

even those small local Visa members who are prepared to bear the losses which result from offering Visa cards without charging periodic fees will be forced to forego offering the premium card if they cannot charge a fee for that service. This new product will then be abandoned to those financial institutions with card operations already large enough to be economically relocated in South Dakota, Delaware, or another equally favorable location.

State legislatures are themselves slowly recognizing the logical error and adverse competitive consequences of denying card issuers the right to charge a fee for the convenience payment feature of cards issued by financial institutions. Today the usury laws in 34 states permit such fees to be charged. That represents only a slight increase in the number of such states during the last year. Eight of those, however, place a maximum permissable level on fees which may or may not have any relationship to economic reality. Reason and fairness dictate that Congress should act now to establish a uniform national policy that recognizes the dual nature of these cards and empowers issuers to price separately the two services which they provide.

Among bills currently pending in Congress, S. 1406, the proposed "Credit Deregulation and Availability Act of 1980", best meets the needs of the financial institutions which issue cards and would make it possible to serve all consumers fairly on an equal basis. That bill would amend the Depository Institutions Deregulation and Monetary Control Act of 1980 by adding new section 531 which would override state laws limiting in any way "covered charges," which would be defined in section 532(a)(1)(B) as including "fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees." S. 963 is unsatisfactory because it fails expressly to preempt state restrictions on periodic, transaction, or access fees, but affects only the amount of the ceiling on finance charges.

The inequities and adverse competitive consequences caused by state restrictions on cardholder fees are exacerbated by the general state usury ceilings on finance charges. The prevailing extreme interest rates and extraordinary credit conditions could not have been anticipated by the state legislatures at

the time that existing state usury laws were enacted. Only a handful of states currently permit card issuers to receive finance charges in excess of 18 percent. While that ceiling may have seemed appropriate when the prime rate was 8 percent and short-term money market rates were 5 percent, it does not permit issuers of Visa cards to break even when the prime rate is 20 1/2 percent and money market rates are at 17 percent.

State legislatures in the past have moved to raised usury law ceilings as changed market conditions have made those ceilings too low. State legislatures are, however, inherently slow-acting institutions. Economic forces in the credit markets move constantly, daily. The Federal Reserve Board meets regularly specifically to attempt to influence the movement of interest rates in the direction it regards as appropriate for the economy. The inability of the states to move equally quickly to adjust usury law ceilings to reflect prevailing market conditions has adversely affected a variety of financial institutions -- but few as dramatically as card issuers.

Congress has the ability to move quickly to make the necessary correction in the law to reflect current credit conditions by preempting the state usury statutes. Although Visa believes that most state legislatures would acquiesce in that decision, it does not object to the provision in S.1406 which empowers those states which choose to do so to overrule the federal preemption by enactment of legislation for that purpose.

With respect to general preemption of state usury law interest ceilings, Visa believes that S.1406 is vastly superior to S.963. The latter bill would substitute a federal interest ceiling tied to the discount rate on ninety-day commercial paper in effect at the applicable Federal Reserve bank. For all practical purposes, such a provision would provide no relief to card issuers. The problems of attempting to implement a floating interest rate on an open-end credit plan would constitute a sufficient administrative nightmare to deter card issuers from attempting to exceed the applicable state usury ceiling.

Visa believes that S.1406 reaches the correct solution by imposing no substitute usury ceiling on consumer loans and leaving interest rates to be determined by competitive market forces. Among card issuers, competitive forces historically have played a major role in determining the terms available to cardholders. For example, in states where periodic fees are authorized, some card issuers nonetheless have elected not to charge a periodic fee in order to advertise that policy as a sales tool to attract more cardholders.

Even ignoring the competition from other cards, from other sources of credit, and from alternative convenience payment mechanisms, there are over 1500 issuing members in the United States from whom one can acquire a Visa card. Visa believes that the competition for accounts among those issuing members will insure that interest rates charged to cardholders will fluctuate in correlation with changes in the cost of funds to Visa members and will not plateau at an unreasonable level when interest rates fall -- particularly if Congress preempts restrictions on periodic fees and thereby enables card issuers in all geographic areas to compete on an equal footing. All experience to date is consistent with the view that the level of card finance charges will be effectively regulated by the free play of competitive market forces.

Senator LUGAR. Thank you very much.
Senator Proxmire.

INCREASE IN BANKRUPTCIES

Senator PROXMIRE. I would like to ask Mr. Gunderson and Mr. Hammer a question. The Consumer Federation says that this legislation will provide no more increase in credit availability and will increase bankruptcies. What's your comment on that?

Mr. GUNDERSON. Well, let's take the bankruptcy situation first. I think there are so many factors involved in the increase of bankruptcies over this past year that you could take those numbers and make almost any kind of a case you want to, but really there are so many areas that I cannot see where the removal of usury ceilings would increase bankruptcies because the lender is still going to use basic credit standards—the evaluation of that borrower—and it's not in our best interest to lead borrowers into undue credit risks. We want that borrower as a long-time customer. We want to work with that borrower and we have a responsibility if we accept him.

Senator PROXMIRE. I presume what the Federation people have in mind is because interest rates will be higher, the debt burden will be higher, that it will be harder for the borrower to pay it off and, therefore, more of a tendency to go bankrupt.

Mr. GUNDERSON. Well, I think here again, you have the evaluation process that would take all those factors into consideration and, of course, we're looking at it in today's high-interest rate environment which we all hope will not be with us indefinitely anyway. We hope to see some improvement there. So it doesn't necessarily say that we are going to be living with these kind of rates. We hope these rates will work their way down.

The problem is that that borrower may not be able to get credit if we continue without preempting usury ceilings. In our own State of Wisconsin right now, we have a law where we can charge up to 18 percent on the first $1,000. With our cost of funds, we are pretty close to borderline. If funds costs continue to increase, we are really going to have to take a long look at our consumer practices.

Senator PROXMIRE. You would deny their argument that there would be no more availability with this legislation. Do you feel that the lender is much more likely to lend if he can have a return which is reasonable?

Mr. GUNDERSON. That's right.

Senator PROXMIRE. And he won't loan if it's not?

Mr. GUNDERSON. He simply can't. The savers have told us they want a market-oriented rate on their savings and we think they are entitled to it. The savers told us they are tired of subsidizing the borrower. So if we're going to attract the funds into our institutions, we have to meet the cost of those funds. If we can't make it on consumer loans, we'll have to look to other alternatives and we would much prefer to offer the consumer loan at a rate we can afford that will earn us a reasonable return and at the same time meet the needs of those consumers.

Senator PROXMIRE. Thank you. Mr. Hammer?

Mr. HAMMER. Let me answer each question in turn, sir, if I may. On the availability argument, I think the evidence is quite clear in the New York case. Most banks in New York were basically out of

the consumer lending business until the rates were temporarily lifted. I have also been asked to look at the portfolios of several of our correspondent banks around the country in States with usury ceilings, and it's clear that they have stopped lending in the consumer market also. So availability will clearly increase once the ceiling is removed.

The bankruptcy issue is another case that I think is a complete red herring. The increase in bankruptcies is not because consumers have overextended themselves. In fact, there's no evidence of that at all. It's just that the law does not address the question of consumers discharging affordable debt and consequently people are going bankrupt because it's easier to go bankrupt under the law than it is to pay, even though they can afford to pay.

The fact that the interest rates will be higher, I think the evidence has shown the consumer has shown a great deal of good judgment in being able to handle it.

Senator PROXMIRE. Mr. Gunderson, I just have one more question. I wonder if the American Bankers Association could give the committee for the record a breakdown by States as to which States still have usury limits and which do not and what they are. I think those facts would be very helpful to us if we had them before us State by State.

Mr. GUNDERSON. Senator, we would be very pleased to provide that. In fact, we should have a study that we are working on right now completed by the end of this week and we will submit it to this committee.

Senator PROXMIRE. Thank you very much.

[The following chart on State usury laws was received from the American Bankers Association:]

EFFECTIVE JULY 7, 1981

BANK CARD RATES/FEES

This chart is intended to present a comparative overview of state usury provisions applying to bank credit cards. Those legislative changes which have temporarily or permanently amended the laws in the past 18 months are indicated. The chart reflects the maximum rates authorized for each state, whether authorized by state statute, federal law or the Most Favored Lender Doctrine.

Per month rates have been annualized to simplify comparison.

In some instances, bank card fees are expressly permitted or prohibited by statute. In others, the practice exists for lack of any statutory or court-ordered prohibition.

Government Relations Division
American Bankers Association

BANK CARD RATES/FEES

STATE	CURRENT RATE	ANNUAL FEES ALLOWED	RECENT CHANGES	EXPIRATION
Alabama	21% - $750 - 18%	Yes, maximum $12/yr.	(1981) Extended temporary provision from 7-1-81 to 6-1-83.	6-1-83; then Then 18%.
Alaska	18% - $1,000 - 12%	Yes	(1980) Was 12%	-
Arizona	N/L	No	(1980) Was 18% - $1,500 - 12%, purchases; 13.96%, cash advances.	-
Arkansas	1% over Fed. Discount Rate incl. surcharge	Yes	-	-
California	N/L (Institutional Lenders exempt from usury limits).	Yes	-	-
Colorado	21%, if 25-day free period; otherwise 18%.	Yes	(1981) Was 18%, no requirement of grace period.	-
Connecticut	18%	Yes	(1981)	3-1-83; Then 15%.
Delaware	N/L	Yes	(1981) Was 18%.	-
Florida	18%	Yes	-	-
Georgia	18%	Yes, maximum $12/yr.	-	-

STATE	CURRENT RATE	ANNUAL FEES ALLOWED	RECENT CHANGES	EXPIRATION
Hawaii	18%	Yes	(1980)	6-30-85;
Idaho	21%	Yes	(1981) [redacted] 18%	-
Illinois	18%	Yes, maximum $20	-	-
Indiana	Greater of 36% - $300 - 21% - $1,000 - 15% or 18% on unpaid bal.	Yes	-	-
Iowa	18% - $500 - 15%	Yes	-	-
Kansas	36% - $420 - 21% - $1,400 - 14.45% or 18% (licensed lenders & unlicensed, under most favored lender doctrine.)	Yes	(1981) Extended temporary alternate provision from 7-1-81 to 7-1-82.	7-1-82
Kentucky	18%	No	-	-
Louisiana	18%	Yes, maximum $12/yr.	-	-
Maine	18%	No	-	-
Maryland	18% - $700 - 12%	No (any fee must not raise the rate over 18%).	(1980) Was 18% - $500 - 12%	-
Massachusetts	18% - $500 - 12%	Yes	-	-
Michigan	18%	Yes, Atty. Gen. Op.	-	-
Minnesota	12% w/$15 annual fee, 18% w/no fee	Yes, maximum $15/yr.	(1979) Was 12% with authority for $15 fee	-

STATE	CURRENT RATE	ANNUAL FEES ALLOWED	RECENT CHANGES	EXPIRATION
Mississippi	21%	No	(1980)	6-30-82; Then 18% - $800 - 15% - $1,200 - 12%
Missouri	22% - $1,000 - 10%	No	(1979) Was 2.218% mo. - $500 - 10%	-
Montana	N/L	No	(1981)	7-1-83; Then 18%
Nebraska	18%	Yes, maximum $20/yr.	(1981) Was 18% - $1,000 - 12%	-
Nevada	N/L	Yes	(1981) Was 21.6%, purchases; 18%, cash advances	-
New Hampshire	No provision	Yes	-	-
New Jersey	N/L	Yes, maximum $15/yr.	(1981) Was 15% - $700 - 12%, purchases; 12% cash advances	-
New Mexico	N/L	No	(1981)	7-1-83; Then 18% - $500 - 16%
New York	N/L	Yes	(1980)	6-30-83; Then 18% - $500 - 12%
North Carolina	18%	No	-	-
North Dakota	18% (N/L under bank interest provision, 18% max. under credit card provision.	No	-	-
Ohio	18%	No	(1980) Was 24% - $200 - 18% - $600 - 12%	-

STATE	CURRENT RATE	ANNUAL FEES ALLOWED	RECENT CHANGES	EXPIRATION
Oklahoma	18%	Yes	Passed; effective approx. 10-1-81 - 30% - $540 - 21% - $1,800 - 15% or 21% on unpaid bal.	-
Oregon	15%	No	-	-
Pennsylvania	15%, purchases; 12%, cash advances, or 5% over Fed. disc. rate.	No	-	-
Rhode Island	21%	No provision. Recent court case finds permissible.	-	-
South Carolina	24% - $650 - 18%	Yes	(1980)	7-1-82; Then 18%.
South Dakota	N/L	Yes	(1979) Was 20%	-
Tennessee	10%, purchases; 5% over Fed. disc. rate, cash advances.	No	-	-
Texas	18% - $1,500 - 12% - $2,500 - 10% <u>or</u> 18%/yr. on unpaid bal. or 26 wk. T-bill rate x2 (but not to exceed 24%)	No	(1981) added alternatives.	-
Utah	18%	Yes	-	-
Vermont	18% - $500 - 15%	Yes	(1980) Was 18% - $500 - 12%	-
Virginia	18%	Yes, Atty. Gen. Op.	-	-

STATE	CURRENT RATE	[illegible]	[illegible]	[illegible]
Washington	4% over rate for 26-wk. T bills	Yes, maximum $[illegible], [illegible]	([illegible]) [illegible]	
West Virginia	[illegible]	Yes	([illegible]) [illegible]	
Wisconsin	18% - $1,000 - [illegible]	Yes	([illegible])	[illegible]
Wyoming	36% - $300 - 21% $1,000 - 15% or 21% on unpaid bal.	Yes	([illegible]) [illegible] on unpaid bal.	

EFFECTIVE JULY 15, 1981

RETAIL INSTALLMENT SALES INTEREST RATES

This chart is intended to present a comparative overview of state usury provisions applying to closed end retail installment sales contracts. A workable overview must necessarily omit various details which make each state's provisions unique. Therefore although variances resulting from different computation methods and fees allowable in excess of the ceiling should be considered, they will not be itemized. Per month rates have been annualized to simplify comparison.

The following should illuminate some of the difficulties encountered in preparation:

A) Time Price Doctrine. This common law doctrine is controlling in several states. It essentially removes interest rate ceilings by a determination that charges for installment sales are not "interest," and are therefore not bound by interest rate limitations.

B) Mobile Homes. It is difficult to determine in all cases under which provision mobile home sales are covered. Some states specifically include them in the definition of motor vehicles, subject to those rates. Others specifically exclude them from that provision. Still others are silent on the issue. When silent, some states consider them general goods and services; others consider them real estate, when used as a primary residence. Sometimes a distinction is made between self-propelled and stationary mobile homes, considering only the former motor vehicles and the latter general goods or real estate.

Again, it is emphasized, this is an overview only. This chart was compiled primarily from information received from state banking associations. Every effort has been made to ensure accuracy by incorporation of the most recent legislative activity and judicial interpretations. However, this chart should not be relied upon without reference to the specific law in each state.

Government Relations Division
American Bankers Association

State/Category	Reference	Rate	Comments	Expiration
Michigan				
General Goods/Services	§19.416(107)	12%-$500-10%	Add-on	-
New motor vehicles	§23.628(18)	16.5%	Add-on	12-1-81; then 12.83%
Used motor vehicles	§23.628(18)	0-2 yrs. used; 19% Over 2 yrs. used; 22%	Add-on Add-on	12-1-81; then 16.25% 12-1-81; then 21.25%
Mobile homes	§19.416(107)	12%-$500-10%	Add-on	
Minnesota				
General Goods/Services	Time Price Doctrine	No limit		-
New motor vehicles	§168.72(2)	10%	Add-on	7-31-83; then 8%
Used motor vehicles	§168.72(1)	2-3 yrs. used; 11% Over 3 yrs. used; 13% + $3 fee	Add-on Add-on	- -
Mobile homes	§168.72(3)	12% (add-on) OR 4½% over federal reserve discount rate on 90-day commercial paper		7-31-83; then same rates as other new/used motor vehicles
Mississippi				
General Goods/Services	§75-17-1(6)	24%-$2,500-21%		-
New motor vehicles	§63-19-43	14% OR 5% over federal reserve discount rate excluding surcharge	Annual Percentage Rate	6-30-82 for alternate
Used motor vehicles	§63-19-43	0-2 yrs. used; 21% 2-4 yrs. used; 26.75% Over 4 yrs. used; 28.75%	Annual Percentage Rate " "	6-30-82; then 18.46% 6-30-82; then 24% 6-30-82; then 26.75%
Mobile homes	§75-17-1(8)	(new/used) 25%-$1,000-18%-$2,500-15% OR 5% over federal reserve discount rate	Annual Percentage Rate	6-30-82 for alternate

State/Category	Reference	Rate	Comments	Expiration
Missouri				
General Goods/Services	§408.300	15%-$750-12%-$1,000-10%-$7,500-no limit	Add-on	-
New motor vehicles, including mobile homes if self propelled	§365.120	10%	Add-on, Max. $7,500 then no limit	
Used motor vehicles, including mobile homes if self propelled		0-2 yrs. used; 10%	Add-on, max. $7,500 then no limit	
		Over 2 yrs. used; 13%	Add-on, max. $7,500 then no limit	
Mobile homes, if not self propelled	§408.250(4)(7)(14) & §408.300 - Time sales	No limit		
Montana				
General Goods/Services	§31-1-241(1)(d)	No limit		7-1-83; then 11%-$300-9%-$1,000-7% (add-on)
New motor vehicles	§31-1-241(1)(a), as amended by HB239(1981)	No limit		7-1-83; then 7% (add-on)
Used motor vehicles	§31-1-241(1)(a), as amended by HB239(1981)	No limit		7-1-83; then 0-2 yrs. used; 9% (add-on) Over 2 yrs. used; 11% (add-on)
Mobile homes	§31-1-241(1)(c)	No limit		7-1-83; then 9% (add-on)
Nebraska				
General Goods/Services	§45-338	18%	Simple	
Nevada				
General Goods/Services	§97.195, as amended by SB101(1981)	No limit		

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State/Category	Reference	Rate	Comments	Expiration
New Hampshire				
General Goods/Services	No provision	No limit		-
New/Used motor vehicles	§361-A, as amended by Ch.127(1981)	No limit		-
Mobile homes	No provision	No limit		-
New Jersey				
General Goods/Services	§17:16C-41, as amended by Ch.103 §13(1981)	No limit	Max. $10,000	-
Mobile homes	Time Price Doctrine	No limit	Min. $10,000	
New Mexico				
General Goods/Services	§56-1-2, as amended by Ch.263(1981)	No limit		7-1-83; then 12%-$300-10%-$1,000-8% (add-on)
New motor vehicles, including mobile homes	§58-19-8 as amended by Ch.263(1981)	No limit		7-1-83; then 9.75% (add-on)
Used motor vehicles, including mobile homes	§58-19-8, as amended by Ch.263(1981)	No limit		7-1-83; then 10% for used 0-2 yrs. (add-on)
		No limit		7-1-83; then 12% for used 3-4 yrs. (add-on) 7-1-83; then 14% for used 5 yrs. and over (add-on)
New York				
General Goods/Services	Personal Property Law, Article 10 §404	No limit		6-30-83; then 10%-$500-8% (add-on)
New motor vehicles	Personal Property Law, Article 9 §303	No limit		6-30-83; then 7% (add-on)
Used motor vehicles	Personal Property Law, Article 9 §303	No limit		6-30-83; then 0-2 yrs. used, 10% (add-on) Over 2 yrs. used, 13% (add-on)
Mobile homes		No limit		

State/Category	Reference	Rate	Comments	Expiration
North Carolina				
General Goods/Services	§25A-15, as amended by Ch.446(1981)	24%-$1,500-22%-$2,000-20%-$3,000-18%	Annual Percentage Rate, Rates apply unless secured by Real Estate then 16%. (Max. $25,000, then no limit)	
New motor vehicles	§25A-15, as amended by Ch.446(1981)	24%-$1,500-22%-$2,000-20%-$3,000-18%	Annual Percentage Rate, Rates apply unless secured by Real Estate then 16%. (Max. $25,000, then no limit)	
Used motor vehicles	§25A-15, as amended by Ch.446(1981)	Greater of rates above OR 1-2 yrs. used; 18% 3 yrs. used; 20% 4 yrs. used; 22% 5 yrs. used; 29%	Annual Percentage Rate	
Mobile homes	§25A-15 (goods and services)	24%-$1,500-22%-$2,000-20%-$3,000-18%	Annual Percentage Rate, Max. $25,000	
North Dakota				
General Goods/Services	§51-13-03, as amended by SB2308 (1981) §47-14-09	No limit - Sellers who comply with disclosure requirements are considered registered lenders. Otherwise, 5½% above 6 mos. avg. 26 wk. T-bills (as non-supervised lender)	Max. $35,000	
Ohio				
General Goods/Services	§1317.06	Base 8% add-on + fees OR 18% simple	Over $700, 18%	

State/Category	Reference	Rate	Comments	Expiration
Oklahoma (UCCC)				
Consumer Credit Sales	14A §2-201	30%-$540-21%-$1,800-15% OR 21%	Max. $45,000	-
Consumer Related Sales	14A §2-102(e)	30%-$540-21%-$1,800-15% OR 21%	Max. $45,000	-
Oregon				
General Goods/Services	No provision-Time Price Doctrine	No limit		-
New/Used motor vehicles, including mobile homes	§83.560	No limit (HB2477 passed 7-13-81; effective on signature)		-
Pennsylvania				
General Goods/Services	69 §1501	15%	Simple	-
New motor vehicles	69 §619	7% when federal reserve discount rate (FRDR) is less than 11%, 8% when FRDR is at 11%, ½ the change when FRDR is over 11%	Add-on, Max. $10,000	-
Used motor vehicles		0-2 yrs. used; 9% Over 2 yrs. used; 12%	Add-on Add-on	- -
Mobile homes	Governed by Federal Housing Administration			
Rhode Island				
General Goods/Services	§6-27-4	21%	Annual Percentage Rate	-

State/Category	Reference	Rate	Comments	Expiration
South Carolina (UCCC)				
General Goods/Services	§37-2-201	36%-$390-21%-$1,300-15% OR 18%	Actuarial	-
New/Used motor vehicles, including self propelled mobile homes	§37-2-211, as amended by Rat. 504(1980)	No limit	-	7-1-82; then new 7%(add-on) 1 yr. used; 8% (add-on) 2 yrs. used; 10% (add-on) 3 yrs. used; 15% (add-on) 4 yrs. & over; 16% (add-on)
Mobile homes, if not self propelled	§37-2-201	36%-$390-21%-$1,300-15% OR 18%	Actuarial	-
South Dakota				
General Goods/Services	§54-3A-3	12%	Add-on	7-1-83; then 10%-$1,000-8%
New motor vehicles, including mobile homes	§54-7-36	Class I - 20%	Annual Percentage Rate	7-1-83; then 15%
Used motor vehicles, including mobile homes	§54-7-36	Class II - 23% Class III - 27%	Annual Percentage Rate	7-1-83; then 18% -
Tennessee				
General Goods/Services	§47-11-103	10%-$500-8%-$3,000-6%	Add-on	-
New/Used motor vehicles	No provision	No limit		-
Mobile homes	§47-11-103	18%	Simple	-

State/Category	Reference	Rate	Computation	Limitation
Texas				
General Goods/Services	Article 5069-6.02	12%-$1,250-10%-$2,500-8% (min. 10% simple) OR 2 times the T-bill rate (max. 24% simple)	Add-on	
New motor vehicles	Article 5069-7.03	7½% OR alternate	Add-on	
Used motor vehicles	Article 5069-7.03	0-2 yrs. used; 10% OR alternate	Add-on	
		3-4 yrs. used; 12% OR alternate	Add-on	
		Over yrs. used; 15% OR alternate	Add-on	
Mobile homes	Article 5069-6A.03	New; 7½% OR alternate	Add-on	
		Used; 10% OR alternate	Add-on	
Utah (UCCC)				
Consumer Credit Sales	§70B-2-201	36%-$660-21%-$2,200-15% OR 18%	Annual Percentage Rate Max. $55,000	
Consumer Related Sales	§70B-2-402	18%	Annual Percentage Rate Max $55,000	
Vermont				
General Goods/Services	§41a(b)(2)	18%-$500-15%	Simple	
New motor vehicles, including mobile homes	§41a(b)(4)	18%	Simple	
Used motor vehicles including mobile homes	§41a(b)(4)	Over 2 yrs. used; 20%	Simple	
Virginia				
General Goods/Services	§6.1-330.21	24%	Annual Percentage Rate	

State/Category	Reference	Rate	Comments	Expiration
Washington				
General Goods/Services	§63.14.130 as amended by Ch.77PV(1981)	Higher of 6% above avg. rate for 26 wk. T-bills OR $10	-	-
West Virginia				
General Goods/Services	§46A-3-101, as amended by SB559 (1981)	18%-$1,500-12% OR 18%	Annual Percentage Rate, Max. $25,000	7-1-82; for alternate
New/Used motor vehicles, including mobile homes	§46A-3-101(6)	18%-$1,500-12% OR 18%	Annual Percentage Rate, Max. $25,000	7-1-82; for alternate
Wisconsin (UCCC)				
General Goods/Services	§422.201	18%-$1,000-15%	Annual Percentage Rate	11-1-81; then 18%-$1,000-12%
New/Used motor vehicles,	§218.01(6)	Lesser of 18% OR 4% over federal reserve discount rate	Annual Percentage Rate	11-1-81; then 12%
Wyoming (UCCC)				
Consumer Credit Sales	§40-14-212, as amended by HB94(1981)	36%-$300-21%-$1,000-15% OR 21%	Annual Percentage Rate, Max. $25,000, then no limit	
Consumer Related Sales	§40-14-257(b)	21%	Annual Percentage Rate, Max. $25,000, then no limit	

For purposes of this chart — CONSUMER CREDIT SALE means a sale of goods or services in which credit is granted to a person by a seller who regularly engages in credit transactions. The sale must be for a personal, family or household purpose, payable in installments or with a finance charge and the amount financed cannot exceed a specified dollar amount.
CONSUMER RELATED SALE is a sale of goods or services which is not generally subject to consumer credit sales provisions, and in which the amount financed does not exceed a specified amount. The buyer must be a person other than an organization and/or the debt must be secured primarily by a security interest in a one or two family dwelling occupied by a person related to the debtor.

BANK INSTALLMENT LOAN INTEREST CEILINGS

This chart is intended to present a comparative overview, only, of the various state usury provisions applicable to banks when making consumer installment loans. The area is one filled with complex provisions varying computation methods and numerous limitations and exceptions. This chart could not possibly include all the modifications which make many states' own unique; it is not intended to be a substitute for a thorough knowlege of the laws of a particular state. Generally covered are consumer loans, not including first mortgage loans or those for business or agricultural purposes.

The following should illuminate some of the difficulties encountered in preparation:

A) Most Favored Lender Doctrine. There is uncertainty regarding the applicability of the Most Favored Lender Doctrine. Some states have enacted comparable provisions enabling state banks, as well as national banks, to apply the most advantageous rates permitted any other lenders. Others have, in practice, applied the doctrine to state banks, apparently without specific statutory authorization. Conflict has arisen over the doctrine's applicability as well as the extent to which particular categories of loans are included.

B) Computation Methods and Fees Vary. In addition to variances in methods of computation, some rate ceilings are inclusive of all fees, while others permit additional fees to be assessed. While monthly rates have been annualized for easier comparison, we have not attempted to identify all incidental fees allowed.

C) Definitional Problems. There is variance among the states regarding the labelling and requirements of certain types of loans, particularly the UCCC (Uniform Consumer Credit Code) states. A few states have adopted the UCCC without change; others have modified it, often reducing the uniformity it was intended to accomplish. Generally "Consumer Loans" rates apply to financial institutions which are not "supervised lenders." Practically, it would seem that most, if not all, banks would be so licensed, if necessary- particularly in states such as Colorado and Iowa, where the difference in maximum allowable rates is so great. Some states exempt banks from licensing requirements while authorizing the use of the higher rates; others do not. Finally, separate provisions for "Consumer Related Loans," generally those secured by an interest in land, exist in some, but not all the UCCC states. Several states have recently repealed this provision.

It should be clear that there are numerous subtleties applicable to each state which make a more comprehensive overview impossible.

This chart was compiled primarily from information received from state banking associations. Every effort has been made to ensure its accuracy and to incorporate the most recent legislative activity and judicial interpretations. However, this chart should <u>not</u> be relied upon without reference to the specific law in each state.

Government Relations Division
American Bankers Association

July 22, 1981

CONSUMER INSTALLMENT LOAN RATES
APPLICABLE TO BANKS

State/Category	Reference	Rate	Comments	Expiration
Alabama				
Bank Installment Loans	Sec. 5-19-3	15%-$750-10%-$2,000-8%-$5,000-no limit OR prime rate (3 largest N.Y. banks) + 2% + optional surcharge. (max. 2% up to $20)	Add-on, max. $25,000	6-1-83; for alternate provision. 7-1-87; no limit on $5,000-$25,000 reverts to 8% (add-on).
Consumer Small Loans	Sec. 5-18-15	36%-$200-24%-$750	Applicable to banks via Equal Interest Bill, Sec. 8-8-1.1	-
Alaska				
Bank Installment Loans	Sec. 45.45.010(b)	5% over federal reserve discount rate (FRDR) effective prior month.	Max. $100,000, then no limit.	-
Arizona				
Bank Installment Loans	Sec. 44-1205(A)(1) OR Sec. 44-1201	Up to $5,000, no limit No limit, any amount.		
Arkansas				
Bank Installment Loans	Const. Sec. 13 of Art. XIX pre-empted by NDCA (1980)	1% over FRDR without surcharge		

State/Category	Reference	Rate	Comments	Expiration
California				
Bank Installment Loans	No provision	No limit	Banks exempt from UNRUH and REES-LEVRING	
Colorado (UCCC)				
Supervised Loans	Sec. 5-3-508	36%-$630-21%-$2,100-15% OR 21%	Max. $25,000	
Consumer Loans	Sec. 5-3-201	12%	Actuarial	
Consumer Related Loans	Sec. 5-3-602	36%-$630-21%-$2,100-15% OR 21%	Max. $3,000	
Connecticut				
Bank Installment Loans	Sec. 37-9	No limit	Banks exempt from usury limits.	
District of Columbia				
Bank Installment Loans	Sec. 28-3308	15%	Annual Percentage Rate	
2d Mortgages	Sec. 28-3301	15%	Annual Percentage Rate	
Delaware				
Bank Installment Loans	T.5 Sec. 963	No limit, including variable rate		
2d Mortgages	T.5 Sec. 3121	No limit		

State/Category	Reference	Rate	Comments	Expiration
Florida				
Bank Installment Loans	Sec. 658.49	Equivalent of 18% simple	Max. $50,000	
Small Loans	Sec. 516	30%-$500-24%-$1,000-18%-$2,500	Applicable to banks via Most Favored Lender, Sec. 687.12	
General Usury	Sec. 687	18%-$500,000-25%		
Georgia				
Bank Installment Loans	Sec. 57-116	9% (add-on)	Over $100,000, no limit (Sec. 57-118)	-
Small Loans	Sec. 25-315	10% (add-on) + fee of 8% on 1st $600 + 4% on excess (max. $3,000)	Applicable to banks via Most Favored Lender, Sec. 41A-1313	
2d Mortgages	Sec. 57-202	9% (add-on) + fees		
Hawaii				
Bank Installment Loans	Sec. 476-33	14% yr. for 1st 18 mos. + 10.5% yr. for next 12 mos. + 7% yr. for next 12 mos. + 4% yr. next 6 mos. OR 24%	Graduated rates are add-on, 24% is simple	7-1-83; then 12% yr. for 1st 18 mos. + 9% yr. for next 12 mos. + 6% yr. for next 12 mos. + 3% on next 6 mos. OR 18% simple
Idaho (UCCC)				
Supervised Loans	Sec. 28-33-508	36%-$660-24%-$2,200-18% OR 21%		
Consumer Loans	Sec. 28-33-201	21%	Max. $55,000	
Consumer Related Loans	Sec. 28-33-602	21%		

State/Category	Reference	Rate	Comments	Expiration
Illinois				
Bank Installment Loans	Ch. 74 Sec. 4a	9% add-on	Max. $25,000 H.B. 438 (1981) removes limit Passed 2 houses, awaiting governor's signature.	
	Ch. 74 Sec. 4(1)	1% over FRDR	Applicable to banks via Most Favored Lender, Ch. 74 Sec. 4	
Small Loans	Ch. 74 Sec. 31	30%-$300-24%-$600-18%-$3,000	Applicable to banks via Most Favored Lender, Ch. 74 Sec. 4	
Consumer Installment Loans	Ch. 74 Sec. 65	8.5% add-on to 30 mos. 7.09% add-on to 60 mos. (min. $800, max. $10,000)	"	
2d Mortgages	Ch. 74 Sec. 4	No limit		
Indiana (UCCC)				
Supervised Loans	Sec. 24-4.5-3-508	36%-$540-21%-$1,800-15% OR 21%	Max. $45,000	
Consumer Loans	Sec. 24-4.5-3-201	21%	Max. $45,000	
Consumer Related Loans	Sec. 24-4.5-3-602	21%	Max. $45,000	
Iowa (UCCC)				
Supervised Loans	Sec. 537.2401	21%	Max. $35,000 unless secured by real estate	7-1-83; then 15%
Consumer Loans	Sec. 524.906	12% Annual Percentage Rate		

State/Category	Reference	Rate	Comments	Expiration
Iowa (cont'd)				
Small Loans	Sec. 536.13	36%-$150-24%-$300-18%-$700-12%-$2,000	Applicable to banks via Most Favored Lender Doctrine	
Industrial Loans	Sec. 536A.23	10% add-on or discount	"	
2d Mortgages	Sec. 537.2307	Under $35,000, max. 21% Over $35,000, no limit		7-1-83; then 15%, under $35,000
Kansas (UCCC)				
Supervised Loans	Sec. 16A-2-401(2)	36%-$420-21%-$1,400-14.45% OR 18%	Applicable to banks, if licensed.	-
Consumer Loans	Sec. 16A-2-401(1)	18%-$1,000-14.45% OR 18%		7-1-82; for alternate provision.
Kentucky				
Bank Installment Loans	Sec. 287.215	8% add-on + fee (max. $10)	Max. $15,000, then no limit	
Small Loans	Sec. 288.530	36%-$800-24%-$1,500-18%-$2,000	Applicable to banks via Most Favored Lender, Sec. 287.214	
Credit Union Loans	Sec. 290.300	18% (simple)	"	
General Usury	Sec. 360.010	Lesser of 19% OR 4% over FRDR		

State/Category	Reference	Rates	Comments	Expiration
Louisiana				
Bank Installment Loans	T.9 Sec. 3519	36%-$1,400-27%-$4,000-24%-$7,000-21%	-	-
2d Mortgages	T.9 Sec. 3503	12% simple		
Maine (UCCC)				
Supervised Loans	9A Sec. 2-401-(2)	30%-$540-21%-$1,800-15% OR 18%	Max. $45,000	-
Consumer Loans	9A Sec. 2-401(1)	12¼%	Actuarial	
2d Mortgages	9A Sec. 2-307	18% Annual Percentage Rate	Max. $45,000	
Maryland				
Bank Installment Loans	Commercial Law Art. Sec. 12-103(c)	18%	Annual Percentage Rate	
Small Loans			Pending litigation questions whether rates, applicable to national banks, are applicable to state banks as well.	
2d Mortgages	Commercial Law Art. Sec. 12-404(b)	16%	Annual Percentage Rate	
Massachusetts				
Bank Installment Loans	Ch. 107 Sec. 3	No limit		
2d Mortgages	Ch. 140 Sec. 90A	18%, if assessed value is $40,000 or less. No limit if assessed value is over $40,000		

State/Category	Reference	Rates	Comments	Expiration
Michigan				
Bank Installment Loans	Sec. 487.491	12.83% + max. $15 service charge	Simple	
Small Loans	Sec. 493.13	31%-$500-13% OR 18% (max. $3,000)	Applicable to banks via Most Favored Lender, Sec. 487.491(c)	
Credit Union Loans	Sec. 490.14	15%. For motor vehicles, 16.5%	"	12-1-81; for motor vehicle provision.
2d Mortgages	Sec. 487.494(4)	15%	Simple	
Minnesota				
Bank Installment Loans	Sec. 48.153 OR	Greater of 4½% over the FRDR OR 12% simple (max. $35,000)		6-30-82; then 12%.
	Sec. 48.195	4½% over FRDR		
Small/Industrial Loans	Sec. 56.131 as amended by Ch. 258 (1981)	33%-$350-19% OR 21 3/4% (simple, max. $35,000)	Applicable to banks via Most Favored Lender	
Credit Union Loans	Sec. 52.14	4½% over FRDR	"	
Mississippi				
Bank Installment Loans	Sec. 75-67-39 OR Sec. 75-17-1	6% add-on OR 5% over FRDR		6-30-82; then 10% Annual Percentage Rate
Small Loans	Sec. 81-5-79	12% add-on OR $15		Max. $2,500

State/Category	Reference	Rates	Comments	Expiration
Missouri				
Bank Installment Loans	Sec. 408.030	10% Annual Percentage Rate OR Quarterly rate, 3% over long term gov't. bond yield. (simple)		
Small Loans	Sec. 408.100	26.61%-$800-21%-$2,500	Max. $2,500	
2d Mortgages	Sec. 408.232	20%	Annual Percentage Rate, Min. $2,500	
Montana				
Bank Installment Loans	Sec. 31-1-107, per Ch. 275 (1981)	No limit		7-1-83; then per Sec. 32-1-436; under $150,000, 10% (simple) OR 4% over FRDR; $150,000-$300,000, 10% OR 5% over FRDR; over $300,000, no limit
Nebraska				
Bank Installment Loans	Sec. 8-820	19% OR $7.50	Annual Percentage Rate	
Nevada				
Bank Installment Loans	Sec. 99.050, as amended by S.B. 101 (1981)	No limit		
New Hampshire				
Bank Installment Loans	Sec. 336.1	No limit		
2d Mortgages	Sec. 398-A:2	No limit		

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State/Category	Reference	Rates	Comments	Expiration
New Jersey				
Bank Installment Loans	Sec. 17:9A-53 amended by Ch. 103 (1981)	No limit		
2d Mortgages	Sec. 17:11A-44, as amended by Ch. 103 (1981)	No limit		
New Mexico				
Bank Installment Loans	Sec. 58-7-1, as amended by Ch. 263 (1981)	No limit		7-1-83; then 8.75% (add-on)
General Usury	Sec. 56-8-11, as amended by Ch. 263 (1981)	No limit		7-1-83; then 3% over FRDR
2d Mortgages	Sec. 56-8-22, as amended by Ch. 263 (1981)	No limit		7-1-83; then 1% over Fannie Mae auction rate
New York				
Bank Installment Loans	Banking Law, Sec. 108(4)	No limit	Max. $25,000	6-30-83; then 6% discount to 37 mos., over 37 mos., 5% discount.
2d Mortgages	Banking Law, Sec. 103(4)(a)	No limit		6-30-83; then 16%

State/Category	Reference	Rates	Comments	Expiration
North Carolina				
Bank Installment Loans	Sec. 24-1.2	Greater or 16% or 6% over 6 mo. T-bill rate for previous month.	Max. $25,000, then no limit	
2d Mortgages	Sec. 24-14(a)	Greater of 18% (simple) OR 5% over FRDR		
North Dakota				
Bank Installment Loans	Sec. 47-14-09	No limit	Banks exempt from usury limit.	
Ohio				
Bank Installment Loans	Sec. 1107.26	10% add-on OR 18% actuarial	-	-
Oklahoma (UCCC)				
Supervised Loans	Title 14A Sec. 3-508A	30%-$540-21%-$1,800-15% OR 18%	(Passed, effective approx. Jan. 1982, S.B. 183 (1981), alt. of 21%)	
Consumer Loans	Title 14A Sec. 3-201	10%	Actuarial	
Consumer Related Loans	Title 14A Sec. 3-602	18%		
Oregon				
Bank Installment Loans	Sec. 708.480, as amended by H.B. 2477 (1981)	No limit		

State/Category	Reference	Rates	Comments	Expiration
Pennsylvania				
Bank Installment Loans	T.7 Sec. 318	5% over FRDR		
2d Mortgages	T.7 Sec. 6609	17.45%	Min. $5,000	
Rhode Island				
Bank Installment Loans	Sec. 6-26-2	21%		
2d Mortgages	Sec. 19-25.2-23	21%		4-1-82; then 15%
South Carolina				
Supervised Loans	Sec. 37-3-201(2)	36%-$390-21%-$1,300-15% OR 18%	Max. $32,500, unless secured by real estate	
Consumer Loans	Sec. 37-3-201(1)	18%		7-1-82; then 12%
South Dakota				
Bank Installment Loans	Sec. 54-3-13	No limit	Banks exempt from usury limits	
Tennessee				
Bank Installment Loans	Sec. 45-2-1106	Graduated scale based on loan length, 10.53%-18%	Add-on or discount.	
General Usury	Sec. 47-14-103(2)	18%	Simple	
Texas				
Bank Installment Loans	Art. 5069-4.01 as amended by H.B. 1228 (1981)	18%-$750-8% OR 2 times the 6 mo. T-bill rate (Min. 18%, Max. 24%)	Add-on	
2d Mortgages	Art. 5069-5.02	8% OR 2 times the T-bill rate (Min. 18%, Max. 24%)	Add-on	

State/Category	Reference	Rates	Comments	Expiration
Utah (UCCC)				
Supervised Loans	Sec. 70B-3-508	36%-$660-21%-$2,200-15% OR 18%	Max. $55,000	
Consumer Loans	Sec. 70B-3-201	18%	Max. $55,000	
Vermont				
Bank Installment Loans	T.9 Sec. 41a(b)(5)	24%-$1,000-12% OR 18%	Simple	
2d Mortgages	T.9 Sec. 41a(b)(7)	18%	Simple	
Virginia				
Bank Installment Loans	Sec. 6.1-330.13:1	No limit		
Credit Union Loans	Sec. 6.1-330.18	18%. Over $5,000, no limit. (Sec. 6.1-330.44)	Applicable to banks via Most Favored Lender, Sec. 6.1-5.3	
Industrial Loans	Sec. 6.1-330.15	18% + 2% finance charge. If maturity exceeds 10 yrs. 2 mos., no limit	"	
Savings & Loan - 2d Mortgages	Sec. 6.1-330.14	No limit	"	
2d Mortgages	Sec. 6.1-330.16	If simple interest & disclosed, no limit; If maturity exceeds 10 yrs. 2 mos., no limit; If add-on, 9%.	"	

State/Category	Reference	Rates	Comments	Expiration
Washington				
Bank Installment Loans	Sec. 19.52.020	4% over the 26-wk. T-bill rate for the prior month.		
Small Loans	Sec. 31.08.160	30%-$500-18%-$1,000-12% -$2,500	Applicable to banks via Most Favored Lender	
Industrial Loans	Sec. 31.04.090	10% in advance + 2% loan fee in advance	"	
West Virginia				
Bank Installment Loans	Sec. 46A-3-104	6% add-on or discount (max. 15% simple) OR 18% Annual Percentage Rate	Max. $25,000	7-1-82: for alternate
Small Loans	Sec. 46A-4-107	36%-$500-24%-$1,500-18%	Max. $1,600. Applicable to banks via Most Favored Lender, Sec. 31A-4-30a	7-1-82; then 36%-$200-24%-$1,200-18%
Industrial Loans	Sec. 31-7-11(5)	legal rate + 2% OR 21% to $5,000	Applicable to banks via Most Favored Lender, Sec. 31A-4-30a	7-1-82; for alternate
2d Mortgages	Sec. 46A-3-104	6% add-on or discount (max. 15% simple) OR 18% Annual Percentage Rate	No max.	7-1-82; for alternate
Wisconsin (UCCC)				
Consumer Credit Transactions, including Consumer Loans	Sec. 422.201	18%-$1,000-15%	Max. $25,000	11-1-81; then 18%-$1,000-12%

State/Category	Reference	Rates	Comments	Expiration
Wyoming (UCCC)				
Supervised Loans	Sec. 40-14-348	36%-$300-21%-$1,000-15% OR 21%	Max. $25,000, then no limit	
Consumer Loans	Sec. 40-14-310	10%	Simple	
Consumer Related Loans	Sec. 40-14-355	Rates for Supervised Loans or Consumer Loans, as applicable		

Senator LUGAR. Thank you, Senator Proxmire.
Senator Dodd.
Senator DODD. Thank you, Mr. Chairman.

Mr. Gunderson and others, it's good to have you here and I'm glad you're here this morning. I have a couple of things. Let me just ask all of you a simple question if I can with regard to the bill which you support.

As you know, it has a provision in it which would allow the States to act on their own within 3 years after the preemption. Do you all agree with that provision of the proposed bill?

REMOVE USURY LIMITS

Mr. GUNDERSON. Well, Senator, I guess if we had our druthers, we would just as soon take the usury limits off and leave them off, but we also recognize the political realities of the world and the feelings of those who drafted this bill that it was an important part in responding to some of the concerns about States rights. So on that basis, we would support it.

Senator DODD. Does that speak for all of you?

Mr. HAMMER. Yes, sir.

Mr. RUSSELL. Yes.

Senator DODD. Just as an aside, Senator Proxmire pointed out earlier that arguing for lower interest rates is a pretty good political issue not only to speak on but to run on, and I might just suggest that I think you're going to possibly create such a flurry of political activity over this issue that you may go back to States like New York, California, and Texas which have done I think the correct thing in the last couple years, as well as other States, moving these 34 States that have at least recognized the problem and have tried to deal with it—maybe not to the full satisfaction of all of you or others, but at least recognized the real economic problems and are moving in that direction—I'd be deeply concerned politically, putting aside the substantive issues—politically during that 3-year period, I guarantee as I sit here you're going to see political activity in every one of these States, including the States where there's been improvement in usury laws, that are going to create some political candidacies on this issue and this issue alone. If you assume that's been done in Arkansas with the votes occurring there, I'll guarantee it's going to happen in New York, Connecticut, California, and Texas and every other State in this country in 3 years, and I would suspect we'll be back at this table and suggesting legislation that does not allow States to impose its own ceiling. Just as a political aside, I think that ought to be considered in debating whether or not we ought to leave this to the States.

At any rate, I know you all oppose indexing and you all indicate in your testimony that you think that's a bad idea. Let me ask some advice. If you were going to advise someone who thought maybe trying to index this were a better way to do it, which indicator would you use, even though I recognize that none of you like the idea of indexing?

Mr. GUNDERSON. It's a long pause.

Mr. HAMMER. Senator, we were asked by Congressman LaFalce, and also he asked the New York State Bankers Association, to do a

study on an index that might be appropriate. We did a good faith legitimate study looking at every possibility and everything we came up with had inequities either for the borrower or some segment of the lending population. We finally said there really isn't any. I think the Congressman testified to that effect last week.

Mr. GUNDERSON. I have the same problems with an index. No matter which one you end up using, you find flaws in it, Senator. I think still, the ultimate index is the marketplace.

Mr. RUSSELL. There's one other problem with an index that's perhaps peculiar to bank card credit, but might be a problem with any open-ended type of credit, and that is if you go with an indexing scheme that implies virtually a floating rate type situation. The operational and accounting problems of any open-end line of credit, particularly one that has a velocity of a credit card account, in trying to follow a floating rate concept, are such that it would be almost impossible for any bank or savings institution to try to follow and build into their program.

Senator DODD. I would be interested in that work that was done. Anyway, some are more onerous than others in terms of indexing. I would be interested in, and you might just respond in writing, which ones you found particularly dangerous in terms of your organizations.

Mr. HAMMER. I would be glad to submit that.

Senator DODD. You sort of responded to this question by Senator Proxmire—I think you did, Mr. Hammer, with regard to Mr. Boyle's testimony this morning with regard to bankruptcies and how he tried to or did track bankruptcies, the greater instances of bankruptcies where the ceilings were higher, and you pointed out you thought the problems were with the bankruptcy laws, not with the ceilings.

I wonder if any of you have any response to that at all?

Have you done any work on that at all?

Mr. HAMMER. I think the basic answer to that is the reason—if the data is correct, and I have not seen that—if it is correct that there are fewer bankruptcies in States with lower ceilings, it would be because availability is much less because the lenders in those States would have to be so tough on credit that they wouldn't take any chances with people.

Mr. RUSSELL. One other thing. There might be a correlation between the rate of interest charged in a State and the unemployment situation in a given State. For example, I don't know what the rates are in Michigan, but I've got to believe their bankruptcy rates are fairly high these days, whereas if you get to a relatively high employment State they may indeed have low rates but you're dealing—it seems to me you can extract statistics like that that are almost amorphous. One doesn't prove the other.

Senator DODD. That's sort of the problem in having them. People can come up with a bag of statistics to prove almost any point and conveniently avoid others that would tend to either disprove the point they are making or at least raise certain questions about it, and I'm finding myself on this argument on this matter being buried in statistics where all the blame is being laid on the ceilings in one case and then where the ceilings are raised it's other statis-

tics that have contributed to either bankruptcies or a decline in the economy of a State or whatever. So it's a rather difficult matter.

Mr. Hammer, I think you certainly made a persuasive argument for the need for Federal action since it is a multi-State situation. It was a good argument you raised, but I'm wondering if you wouldn't agree that that argument is equally applicable or should be applicable to consumer protection laws; that if we're going to address this issue maybe we should preempt all elements of the loan transaction, not just one element of the loan transaction as is being advocated here. And, if so, which consumer protection laws would you like to see included in this legislation if you agree that we ought to deal with the whole transaction and not just one part of it if you're dealing with multi-State matters?

Mr. HAMMER. It seems to me the many statutes passed at the Federal level on consumer protection over the past 15 years have given rise to no evidence that they are not working, and if you layer those on top of what the States already have and the layer on top of the known contract law, it's not a real problem. The laws are so comprehensive already that it seems to me the protections are there.

Senator DODD. Don't you run into the same thing if we're going to deal with this and preempt you've got the multi-State creditor. I think to use the automobile in a sense that here's—I don't know how far this argument is going to go in dealing with your 50 different jurisdictions—a creditor has got to prepare to deal with in as many States as he has businesses in and certainly that creates a problem for him. So it would seem to me if we're going to eliminate one part of the problem that it would be in his interest, as well as the consumer's interest, to try and apply some of the consumer protections across the board with this legislation.

Mr. HAMMER. Well, you have the problem of Federal involvement versus States rights obviously there.

Senator DODD. That's selective, though.

Mr. HAMMER. Yes, it has been selective, but those 12 or 15 major consumer protection statutes that have been advanced over the past few years, while selective, are awfully comprehensive. But I must say, essentially, I think you have a point.

Senator DODD. My time is up.

Senator LUGAR. Thank you, Senator Dodd.

Gentlemen, earlier this morning when we were discussing how credit controls might work in trying to hold interest rates to a dull roar at least, Mr. Schechter of the AFL-CIO suggested that during credit controls last year interest rates went down and this relieved a good number of problems, and one of his theories was that what we are really looking at is a situation of high-interest rates and that relief from that generally might relieve our entire problem.

Now correspondingly, other arguments have been made that the usury ceiling in Arkansas or elsewhere, for that matter, have the effect of restricting credit, that people stop borrowing and stop extending credit and that may be a useful result. We have not really extensively taken a look philosophically at that problem in terms of freedom of choice, freedom of purchase or consumer freedom at all.

The assumption has been essentially that somehow or other the consumers got along, they kept buying even though we were arguing on the other side—at least those gentlemen were—that there were times when the consumer maybe shouldn't have the opportunity to consume, to buy automobiles or buy whatever else it is, that they may decide collectively that enough is enough, and they sort of go back in a hole and are quiet for a while until the economy changes.

I highlight this argument because it seems to me a very strange and curious argument, that a large majority of Americans would not accept at all. I would gather, for example, that most members of the AFL-CIO would not buy the idea that people ought to stop buying automobiles for long periods of time or that a good number of consumers in our country should just stop buying. It seems to me implicit in all of this that we are talking about how we facilitate consumer choice, and the problem of doing so in an economy in which interest rates are high and may go higher and bump up against these ceilings; and my question then becomes not whether consumers ought to be restricted by the Federal Government or by State governments, but how they might be facilitated?

VISA NOT AFFECTED BY USURY CEILINGS

What seems to me intriguing about the testimony of this panel, beyond all the important arguments that you've made, is the fact that there has been institutional change of many sorts—the VISA testimony particularly is interesting because through the electronic banking medium apparently, as you say, 64,500,000 people in this country are holding these cards. That's almost a third of our entire population and for various reasons they are not affected by any of what we are talking about today. None of the usury ceilings apply. VISA is not the only card issuer, of course. There are other people in this business. And my guess is, by the time we added all these cards together, that most people in our country—in fact, you may know precisely the percentage of persons—have in fact already evaded the whole usury ceiling problem successfully.

So, as you pointed out, either individually or collectively, what we're talking about, quite apart from anything we got into to begin with as a consumer, is a large bank-small bank problem in a way or electronic medium as opposed to a stationary institution situation, which is a national question. As you pointed out in the VISA testimony, you said the largest financial institutions have already absorbed the initial startup cost of a credit card operation and therefore are in a good position. In fact 20 out of 1,500 people issuing cards now issue 50 percent of them. So if, in fact, we continue on the track that we are now on, with the hodgepodge of state usury ceilings, your argument is, I gather, that in fact the large will get larger and the small may not exist at all, at least in the credit card business, and finally will be restricted to very local situations, under very local conditions, and that if one was arguing in terms of competition of banking institutions in this country and the proliferation of many persons who might offer credit, one would have to argue in favor of a national system because we are already in the process of having one whether we want it or not. And the net effect of failure to pass this bill will simply mean that

more of those small institutions will be at some point out of the consumer credit business altogether, to the detriment of those communities, the banks, savings and loans and whoever else is involved in it. This may overstate the argument you were driving at, but I stated this baldly just to gain the reaction of each of the three of you.

Is this essentially what we are talking about? Why is this a national problem? It is a consumer problem, but we are really talking about the institutional questions of large banks, small banks, electronic situation as opposed to the stationary situation. Would you comment at all on that idea?

Mr. RUSSELL. I would be delighted to. First of all, with respect to the usury statutes, you can't really say that the banks by virtue of the national scope of issuing cards have gotten completely around the usury statutes. Some banks have by virtue of either where they are domiciled or where they have moved their operations, so they are operating in States that are statute free.

Senator LUGAR. If I may interject at this point, if there were one State in the Union that did not have a usury ceiling, then the ballgame is over. Everybody who wanted to issue cards would go to that State and start issuing them.

Mr. RUSSELL. That would be enough to provide that loophole. Now the unfortunate thing is the smaller institution can't afford to do that because there are capitalization requirements and considerable expenses as well as all the other things necessary to operate a facility remote from your corporate headquarters. In addition to not being able to afford it, most institutions other than banks can't even legally do it. So that you automatically eliminate the credit unions and the S&L's. What the usury statutes effectively do is they preclude to a great extent the local issuance of credit and turn that market de facto over to someone who can charge a reasonable fee, enough to make some money in the business, who then comes into that local market and establishes those customer relationships. And I think you have summarized it very eloquently.

Mr. HAMMER. And he probably does so less efficiently because local collection of debts is much more efficient than trying to do it from afar.

Mr. DUMLER. Senator, if I could add one statement, we do know that this type of credit extension is much different than almost anything else we do. In my particular institution, which is a unit bank in Colorado, the single outlet, we have nearly 50 percent of our total credit card customers outside the State of Colorado. Most of that is because of the ease of making that service available and continuing to support those customers who perhaps took on our service 10 or 12 years ago who would like to continue it but perhaps with our mobile society have now moved. So I think the distribution networks we have today indeed have changed and for our institution to have a unique advantage over a Little Rock bank or a customer that resides in Arkansas seems to me to be a real problem.

Senator LUGAR. I think that's an intriguing idea. A small bank in Colorado and 50 percent of your business is with people outside of that State, and it's an important thought because geographically we are pegged in this hearing thinking about State laws and

almost oblivious of how commerce actually occurs in this country today.

Mr. RUSSELL. I would like to make one other point. We have referred to Arkansas so often, I'd like to focus on some other States which perhaps commercially are significantly more important than Arkansas. The State of Pennsylvania, for example, which I'm familiar with, has a 12-percent usury statute on the cash advance aspect of credit cards and 15 percent on purchases. They are permitted no annual fees. They recently reviewed that statute in the legislature and chose to do nothing about it. So there is no immediate relief in a significant State. Oregon is another example that has a 15-percent cap, no fees, no relief immediately in sight. If it were perhaps isolated with Arkansas, the problem might not be serious; but, unfortunately, it is not. It's rather widespread.

Senator LUGAR. Would any of you be able to offer, with regard to those significant States—Pennsylvania, Oregon—how are people getting consumer credit in those States?

HOLDING ACTION

Mr. RUSSELL. What's happening now is kind of a holding action. Most of the banks in these States have not yet begun to significantly turn off consumer credit because they are hoping for either one of two things to happen—either the cost of money to go down, which seems to be more and more a forlorn hope; or some kind of relief either nationally or on a statewide basis on usury.

This holding action can only last so long and I think it is beginning to wear rather thin around the edges. I would not be surprised to see some cutting back if things don't materialize pretty quickly.

Mr. HAMMER. I think basically that we have already seen the signs of lower availability in those States. The bank I mentioned earlier, the correspondent that I was asked to look at, happened to be a Pennsylvania bank. They are just not lending anymore. Another Pennsylvania bank I know of has resold their credit card portfolio. So it's taking effect, no question about it. When I said that the conditions were intensifying and the rates would stay the same, you can lose money on your portfolio for several months and your boss looks at you and says, "That's not too good." If it goes on for 6 months or a year, he says, "That's bad." That's a little different.

Senator LUGAR. Then you're called in as a consultant and it's terminated.

Gentlemen, we appreciate very much your coming today and thank you for your testimony.

The Chair would like to now call a panel comprized of Frank L. Coffman, Jr., president, First Federal Savings & Loan, Harrison, Ark., on behalf of the National Savings & Loan League; Philip R. Brinkerhoff, president, Federal Home Loan Mortgage Corp.; Joseph N. Cugini, chairman, Credit Union National Association; and Vernon J. Dwyer, secretary of the National Association of Federal Credit Unions, manager of the Pentagon Federal Credit Union, Arlington, Va.

Before you commence, gentlemen, a gentleman from Pennsylvania has indicated that for the sake of the record the Pennsylvan

law was amended last year and banks are able to charge, at least according to this gentleman, 5 percent above the discount rate, and there are other changes that were made in that law. But for the sake of the record, I have asked the staff to check on the Pennsylvania case and we'll make certain our record is clear. It may not affect the dialogue and the argumentation, but for the sake of accuracy we want to make certain we have that data.

At this point I would like to call upon you gentlemen to testify in the order I introduced you. First of all, Mr. Frank Coffman.

STATEMENT OF FRANK L. COFFMAN, JR., PRESIDENT, FIRST FEDERAL SAVINGS & LOAN, HARRISON, ARK., ON BEHALF OF THE NATIONAL SAVINGS AND LOAN LEAGUE

[Complete statement follows:]

Testimony of
Frank L. Coffman, Jr.
on behalf of the
National Savings and Loan League

Mr. Chairman, Members of the Subcommittee, I am Frank L. Coffman, President of First Federal Savings and Loan Association of Harrison, Arkansas. I am here today speaking on behalf of the National Savings and Loan League.

Mr. Chairman, last year the Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 (PL 96-221), one of the most significant financial institutions bills to be signed into law in fifty years. The purpose of that legislation and many of its specific provisions bear directly on the issue before this Subcommittee today.

By enacting this legislation, Congress set in motion a six-year transition toward a more competitive, free market environment for the nation's financial institutions in which rates paid to savers by commercial banks and thrift institutions on all forms of savings will be set by the market rather than by regulators. The Congress had two objectives in mind--equity for savers and enhancement of the competitive position of banks and thrifts vis-a-vis nondepository competitors, such as money market mutual funds. The Congress recognized, however, that the nation's savings and loan associations are not able to compete directly with banks in a free market environment because thrift assets are restricted essentially to long-term, fixed-rate mortgage

loans and because the range of services they can offer is limited.

To improve the competitive position of the savings and loan industry and permit it to increase earnings, PL 96-221 provides, among other things, NOW account authority, trust account powers, and a limited authority for consumer lending. The new law allows a federal savings and loan association to have up to 20% of its assets in consumer loans, secured or unsecured.

Profitable consumer lending will be critical to the future viability of many savings and loan associations. If, as the law mandates, we are going to pay depositors a market rate of return on their savings, we have to be able to earn a market rate of return on our assets. To do this, the asset portfolio has to be more market sensitive. This can best be accomplished by improving the mortgage instrument itself (a goal which the FHLBB has pursued vigorously and constructively) and by diversifying the institution's assets structure to include shorter maturity, high turnover loans so that the income to the association keeps pace with economic cycles and fluctuations in market interest rates. Obviously, consumer loans can contribute to this objective.

The Congress recognized that even under the best of conditions, thrift institutions can not accomplish this asset adjustment overnight, and provided accordingly a

six-year transition leading to the end of Regulation Q. The consumer lending business is already highly competitive because banks, finance companies and credit unions compete for the same market. As a practical matter, it will be several years before savings and loan associations capture a significant share of this market. Of course, the more competitors there are in the market, the better from the consumer's point of view.

It should be obvious, Mr. Chairman, that the consumer lending aspect of PL 96-221 can only accomplish its stated objective if savings and loan institutions can profitably pursue this line of business. One of the primary obstacles to a profitable consumer lending program today is the existence of outdated, arbitrary, rigid usury laws in many states.

Economic Uncertainty

Several economists have advised the National League that we can expect inflation to continue at or near 10% per year for the foreseeable future and that, given Federal Reserve monetary control policies, interest rates will continue to be highly volatile. In this kind of economic environment, interest rate ceilings, which are not quickly or readily responsive, result in distortions of the credit market. Credit availability is restricted where the anticipated return is below generally prevailing rates.

Consumer interests and the overall efficiency of our economy will be better served by a system that allocates credit by price and competition.

The demand and need for credit in the context of economic uncertainty justifies the preemptive actions taken by Congress in PL 96-221 and also justifies extending the general preemption of mortgage lending usury ceilings to consumer lending.

Moreover, when national market interest rates fluctuate as greatly as they have this past year, fixed usury ceilings distort the allocation of credit and inhibit the overall efficiency of our economy's delivery of goods and services. Where usury ceilings are substantially below market rates, credit is restricted.

Market interest rates in every state are virtually dictated by policy decisions made here in Washington. Every savings and loan association in the country is subject to the fiscal and monetary policy actions of the Congress, the Treasury and the Federal Reserve. Actions of these federal authorities have resulted in a situation where the rates we must pay to attract savings is higher than the return on existing loan portfolios and, in many cases, higher than loan rates permitted by state law. We feel justified, therefore, in urging the federal government to give us relief

from usury restrictions since federal government policy is the key determinant of our cost of funds.

Due to market conditions, an ever-increasing dependence on short-term, market-sensitive deposits, and recent actions of the DIDC, the deregulation of our liability structure is proceeding much faster than anyone expected on March 31, 1980. The elimination of interest rate controls has increased the cost of funds to financial institutions. Costs incurred by these institutions are essentially a function of national economic events and policies. States neither determine these policies nor can they protect institutions from their effects. It is inequitable to both lenders and borrowers for the cost of funds to be determined on a national level while decisions regarding interest rate ceilings on credit extensions are left to state governments. The costs and price of funds are directly related, and the federal government should recognize this relationship.

Many members of this subcommittee will recall that we made these same arguments in this hearing room with respect to mortgage credit in 1979 and 1980. We firmly believe that the case for federal preemption is equally justified for consumer loans.

Interagency Task Force on Thrift Institutions

One of the provisions of PL 96-221 was the creation of an interagency task force set up for the purpose of looking ahead to the future of the thrift institutions of this country and making a report of its findings and recommendations to the Congress. The Report of the Task Force, filed on June 30, 1980, contains an analysis of state usury laws governing consumer lending. The findings of the Task Force are essentially consistent with the view we have expressed here today. We were greatly encouraged by their recommendation that Congress seriously consider a general preemption in the area of consumer credit.

As to the importance of this issue to the thrift industry, the Task Force said:

> "And any improvement in the functioning of the consumer lending market could enhance the ability of thrifts to participate directly in this area. This could improve thrifts' ability to compete with other financial intermediaries for consumer deposits as well as improve thrifts' earnings through their participation in the consumer credit area."

The Task Force also concluded that:

> "Thrifts may have little incentive to diversify into consumer lending as long as state restrictions on finance rates make such lending unprofitable. The problems generally caused by usury limits are not new but have been more evident recently as market interest rates rose above these ceilings. As the cost of funds rises but usury ceilings restrict the permissible finance rate that may be charged, lending institutions channel funds into other types of loans or other geographic markets."

Finally, as to the impact on credit availability and consumer protection, the Report says:

> "Permitting thrift institutions to offer a wide variety of credit potentially increases the options available to borrowers. This in itself should reduce the need for usury ceilings as a protection for consumers against monopolistic lending practices. At the same time, consumer lending undertaken by thrifts could provide increased cash flow and, after start-up costs are covered, more flexible earnings for thrifts, thus strengthening their long-run ability to provide mortgage-origination services and to attract deposits as a source of funds as well."

S. 1406 and S. 963

The National League welcomed the introduction of the two bills before the subcommittee today. We are grateful to Senators Bumpers and Pryor for introducing S. 963 and Senators Lugar, Garn, D'Amato and Proxmire for sponsoring S. 1406.

S. 963 would permit any lender to lend at a rate of up to 1% above the Fed discount rate (inclusive of surcharges). I am advised that currently this approach would permit loan rates of up to about 19% in states with usury ceilings below that rate. While this legislation would certainly help my institutions and other lenders in Arkansas (where we currently have a 10% usury ceiling), it is the opinion of the National League that S. 963 is not the most desirable approach. There are two reasons for this. First, the arguments we have made are equally applicable to usury ceilings whether they be state or federal in origin. Second, while there is an historic virtue to the discount rate index, it

is, given today's economic environment, a very unsatisfactory index. The discount rate is a regulatory tool of the Federal Reserve and, as such, cannot be relied on to reflect market swings affecting our institutions' cost of funds.

The National League's preference is for a total usury preemption such as would be provided by S. 1406. This bill would extend the mortgage preemption approach of P.L. 96-221 to the consumer and business and agriculture loan fields with the opportunity for each state to reimpose a usury standard [illegible]. Not only does S. 1406 protect the right [illegible] to reimpose usury limits [illegible] [illegible] consumer protection with respect to small transactions. The bill preempts state law only with respect to restrictions on the terms and conditions of consumer credit contracts [illegible]. In this case, competition is the consumer's best protection.

Conclusion

Mr. Chairman, the National League appreciates this [illegible] [illegible] [illegible] questions.

Senator LUGAR. Thank you very much, Mr. Coffman. I want to mention that Representative Hammerschmidt called the Chair and wanted to give a special greeting to you during your appearance here today.

I call now upon Mr. Philip Brinkerhoff.

STATEMENT OF PHILIP R. BRINKERHOFF, PRESIDENT, FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. BRINKERHOFF. Thank you, Mr. Chairman.

As president of the Federal Home Loan Mortgage Corp., I'm very pleased to testify today in support of legislation which would broaden the Federal preemption of State usury laws to include consumer loans.

[Complete statement follows:]

Statement of

PHILIP R. BRINKERHOFF
President

FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. Chairman, members of the subcommittee, I am Philip R. Brinkerhoff, president of the Federal Home Loan Mortgage Corporation. I am pleased to testify today in support of legislation which would broaden the federal preemption of state usury laws to include consumer loans. The corporation has a special interest in S.1406 and S.963 since restrictive usury ceilings in a number of states currently limit lenders' ability to participate in the corporation's home improvement loan purchase program.

The Federal Home Loan Mortgage Corporation was established by Congress in 1970 to establish and promote a secondary market for conventional loans. During the past 10 years, the corporation has purchased over $25 billion in mortgages and sold over $20 billion in conventional mortgaged-backed securities. Congress authorized the corporation to purchase energy conservation loans and home improvement loans in December 1978.

In January of this year, the Mortgage Corporation began the first nationwide pilot secondary market for purchase of these loans. Since that time, over 9,000 lenders across the country have expressed interest in qualifying to participate in the program. These include savings and loan associations, mutual savings banks, commercial banks, mortgage banking companies and credit unions. Other consumer lenders which qualify as FHA Title 1 lenders may also participate if they meet prescribed requirements. We have completed a series of fourteen seminars across the country to acquaint lenders with our program. More than 2,700 lenders attended.

Many of the lenders who have expressed an interest in our program currently do not offer home improvement or energy conservation loans because their savings deposits are inadequate to support such programs and there is currently no secondary market which such lenders can tap for outside funds.

Under our program, a lender is able to make home improvement and energy conservation loans and sell to the corporation a participation interest of 80 percent in each loan. With the proceeds from the sale, the lender can originate other home improvement loans. A summary of our home improvement loan program features is attached to our statement. Active participation in our program will enable lending institutions to make further contributions to local efforts to promote home rehabilitation, neighborhood revitalization, and energy conservation activities.

Unfortunately, the availability of our new program will not result in open loan windows in those states where state usury ceilings for junior mortgages and consumer loans are set at unrealistically low levels. A similar situation existed for conventional mortgage loans prior to the action taken by Congress last year.

Without this legislation, lenders in states with usury ceilings that are set at below market levels will not be able to originate loans with sufficient yields to cover their costs and meet our required program yields. The yields we will require on the loans we

purchase under this program will reflect the cost to us of borrowing funds in the capital markets plus our own costs of doing business. While our pilot home improvement loan program is currently financed with debt, we hope to finance these purchases in the future by the sale of securities which represent an ownership interest in these loans. We have designed our home improvement loan program to operate in a streamlined manner so our own costs will be minimized. Therefore, the major determinant of our yields will be the rates we have to pay for funds in the capital markets.

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides a federal preemption of state usury laws applying to first mortgages. In addition, the Act provides that federally-insured depository institutions may originate loans other than first mortgages at rates which do not exceed the greater of either the state usury ceiling or one percent above the Federal Reserve discount rate. In today's market, this option does not provide meaningful relief for secured and unsecured consumer lending because the Discount Rate is at 14 percent -- substantially below the market rate for such loans. FHA Title 1 home improvement loans already enjoy preemption under the Housing and Community Development Amendments of 1979. S.1406, as drafted, would preempt state usury laws for secured and unsecured consumer loans and credit cards and would expand lenders' access to the corporation's home improvement loan purchase program.

Over the past several months, we have conducted a survey of state law to determine the effect of state usury ceilings on lenders' ability to participate in our program. A copy of the survey results is attached. The survey indicates two significant problem areas where state usury ceilings restrict use of the corporation's program and illustrate the compelling need for the relief provided in S.1406.

In 31 states, the usury ceiling is either at or below the rate which lenders must charge to meet the corporation's required net yield plus a reasonable spread for the lender's profit and administrative costs. The corporation's most recent required net yield for home improvement loans is 16.5 percent. Lenders generally add 1-1/2 percent to cover their cost and profit. Therefore, the lowest interest rate which most lenders would charge to profitably originate home improvement loans for sale to the corporation is 18 percent. The states with rates at or below 18 percent are identified in the third column of the survey as causing actual or potential problems for the corporation. Lenders doing business in these states would therefore be precluded or significantly restrained from participating in the corporation's program.

An "actual" problem, from the corporation's viewpoint, exists when the usury ceiling is at or below the current net yield required in our program. Lenders in these states cannot legally originate loans at a rate high enough to meet the corporation's minimum interest rate requirement. A "potential" problem exists where the usury

ceiling is equal to or less than 18 percent for any class of lender. Although lenders in these states can meet our miniumum required net yield, they would have to originate home improvement loans at a loss or a less than acceptable profit. Since both the corporation's required net yield and many usury ceilings are variable, the number of "problem" states constantly changes with interest rate fluctuations.

The second major problem which usury ceilings cause for lenders originating home improvement loans for their own portfolio or sale to the corporation is the complexity of state usury laws. It is very difficult to determine the actual maximum rate at any particular time. This complexity stems from several factors. Floating rates appear to be in vogue these days and contribute significantly to the complexity of deciphering state usury laws. As our survey indicates, at least ten different indices are used to determine state usury ceilings. Many of the indices are either difficult to obtain or require additional computation (such as determining the average rate of 26 week Treasury bills for a one month period) and subsequent administrative action by a state official who then sets the usury ceiling. An additional problem with floating rates is that they tie yields to the supply and demand for a different instrument. These yields do not necessarily reflect the supply and demand for home improvement loans and, therefore, ignore market forces and create inefficiency in this market.

Another major factor which contributes to the complexity of state usury laws is that rates may vary depending upon the type of lender or the type of loan. For example, in many states, so-called "regulated" lenders are exempt from usury limits. However, mortgage bankers and consumer finance companies in the same jurisdiction may be subject to a restrictive usury ceiling which excludes them from participating in the corporation's home improvement loan program. Often the usury ceiling varies with the term and type of loans. For example, in some states, the rates differ if the loan is subject to a "small loan" or retail installment act or if the loan term is for less than a certain number of years.

Although the corporation has attempted to insulate itself from the necessity of monitoring usury ceilings by requiring sellers to warrant that each loan complies with applicable usury laws, on several occasions the corporation has been forced to obtain an interpretation of state usury laws. For example, in Kentucky and Texas, the ability of lenders to originate simple interest loans was uncertain because the state usury laws referred only to "add-on" interest. Lenders in these states would not originate simple interest home improvement loans (simple interest is required under our program) until this problem was resolved. The corporation was required to obtain an opinion from both states to clarify how interest could be calculated under the applicable usury law. This was a lengthy and costly process.

This complexity has a significant dampening effect on lender participation in the corporation's program, especially as the movement toward nationwide lending increases. A nationwide lender intending to originate home improvement loans for sale to the corporation must be equipped for the difficult and time-consuming task of deciphering and continuously monitoring usury laws in all of the states where it operates. The commitment of time and resources necessary to support the lender's warranty to us that each loan complies with applicable usury laws may become a significant barrier to participating in our program for many of these lenders.

Usury ceilings originated in an era when a community's credit demands were met largely from funds within the state. Today, this is no longer true. Local credit markets are closely tied to and dependent on national and indeed, international credit markets. During the past two years, even the smallest financial institutions found they were competing for savings dollars with a myriad of investment opportunities their depositors were anxious to explore.

The phase-out of Regulation Q and the new investment powers granted to thrift institutions in the Depository Institutions Deregulation and Monetary Control Act of 1980 reflect the interrelationship between local, national and international credit markets, as well as the increased sophistication of individual depositors.

The inclusion of the federal preemption of state usury ceilings for mortgages in this landmark legislation rests on Congress' realization that institutions must be able to originate loans at realistic yields if they are to offer savings account rates that will attract and keep depositors.

The consumer lending authority granted to thrifts in the Deregulation Act is a vital tool to help these institutions raise their earnings and offset some of the losses due to their large holdings of older low-yielding mortgages. However, lenders in states with low usury ceilings will be denied use of this new investment authority without broadening federal preemption to cover consumer loans.

It may be helpful to the committee to examine the impact of the federal preemption of state usury ceilings for mortgages. From the Mortgage Corporation's vantage point, I can say without reservation that the federal preemption you provided last year has increased the supply of mortgage funds available in many states which had restrictive usury ceilings. For the greater part of 1979, lenders in 22 states were unable to originate home mortgages at rates which would cover their costs and be competitive in the national secondary mortgage market. Lending activity and consequently, building activity in those states was significantly dampened as interest rates climbed and institutions experienced disintermediation.

For example, restrictive usury ceilings in New York were particularly harsh in closing off secondary mortgage market sales activity. New York lenders did not bid successfully in the Mortgage Corporation's auctions from 1974 until after preemption. Lenders in other states sold us over $23 billion in home mortgages during those six years.

Since last year's federal preemption was passed, lenders across the country have reopened their home mortgage windows. We have seen a dramatic increase in participation from lenders in the 11 restrictive usury states. Activity has been especially heavy in the Northeastern states.

For the same reasons, expansion of the usury preemption provisions to include junior mortgages will ensure access to our home improvement loan program for lenders in all states just as the federal preemption for mortgages broadened participation in our mortgage programs. In an era when Congress has placed a high premium on neighborhood revitalization and energy conservation, it would be inconsistent to permit state usury ceilings to stand as barriers to these goals.

I am aware of the consumer protection issues raised by some opponents of federal preemption of state usury laws. In today's housing market, competition among lenders, which will be further

enhanced by the growth of the secondary market, will hold rates at levels consistent with rates generally prevailing across the country. This competition provides the same protection to consumers that state usury ceilings were originally intended to give when the number of lenders was small and the only available funds were contained within the community.

Recognizing this, states which have exercised their right to reverse the federal preemption have, with the exception of Kansas and Maine, not reimposed a usury ceiling.

S.1406 preserves consumer protections provided under state law and also gives states the right to reject the federal preemption at any time within three years of the date of enactment.

The bill introduced by Senators Bumpers and Pryor is also intended to relieve restrictive usury laws and provide temporary relief to retailers excluded from the preemption passed last year. The bill, which is more limited in scope than S.1406, would allow any person or organization to extend consumer credit on the same terms as financial institutions under the omnibus bill of last year. The provisions of the legislation would extend until April 1, 1983, with a provision to allow states to override the federal preemption at any time.

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While I support the intent of S.963, the bill, if approved, would not provide the relief needed in the 31 states where lenders experience actual or potential problems participating in the corporation's home improvement loan program. Under S.963, loans for home improvement loans may be originated at one percent above the Federal Reserve Discount Rate which is currently 14 percent. A loan originated at 15 percent, while it may be a significant improvement in the state of Arkansas where the usury ceiling is constitutionally set at 10 percent, would still not be salable to the corporation since our current yield is 16.5 percent. The Discount Rate, which is a very short term rate, is an inappropriate index for home improvement loans which have much longer maturities. For these reasons, the corporation supports S.1406 as a more comprehensive approach to the problem of state usury ceilings.

I would be happy to respond to any questions you have.

(Note: This survey summarizes the usury ceilings applicable to secured second mortgages as of July 1, 1981, or as otherwise indicated. The survey was prepared primarily from secondary sources, so recent changes in usury rates may not be reflected. Also, rates may differ by type of loan, loan size, loan term and type of lender. Some floating rates are not stated).

HIL USURY SURVEY

STATE	INTEREST CEILING	ACTUAL OR POTENTIAL PROBLEM FOR HIL PROGRAM
1. Alabama	a. No limit for loans of $5,000 or more. (Effective to 12-31-81)	
2. Alaska	a. Floating Rate. 1/ for loans of $100,000 or less. (18% as of 4-31-81)	Potential
	b. Installment loans ($10,000 maximum, for a term of no more than 7 yrs.) may be made at 6% add-on but cannot yield in excess of 11.1% per annum or 11.8% per annum, if discounted.	
	c. Licensees under Small Loans Act may make loans from $5,000 - $25,000, and may charge the greater of 18% per annum or 8% points above floating rate in (a) above.	
3. Arizona	a. No limit	
4. Arkansas	a. 10%	Actual
5. California	a. No limit for designated institutional lenders (these institutional lenders include state building and loan associations, state industrial loan companies; state credit unions; state banks; national banks; state non-profit agricultural associations; licensed real estate brokers for real estate secured loans. Federal S & L Associations are not listed, however, exemption from usury limits is generally acknowledged as applicable on constitutional grounds.)	
6. Colorado	a. 12% for consumer loans of $25,000 or less 17/, 18% for "supervised loans".	Actual
	b. 45% on loans of more than $25,000	
7 Connecticut	a. No limit on loans of more than $5,000 18/. National banks, state banks, state and federal savings and loan associations and "any private banker" are exempt from usury limits.	
8. Delaware	a. The higher of 18% or a floating rate 2/ for licensees under the Second Mortgage Law.	
	b. Small loans may be made by institutional lenders at any rate.	
9. D.C.	15% 19/	Actual
10. Florida	18% 19/ - But usury limits are inapplicable to loans made pursuant to a commitment to purchase in whole or in part by FNMA, GNMA and FHLMC	
11. Georgia	Floating Rate 3/ 16% as of June, 1981 For second mortgages on 1 - 4 residences, a lender may charge 9% add-on interest on principal which may also include an additional 10% "Rate of Charge"	Actual
12 Hawaii	12% 19/ Industrial loan companies may make second lien loans at 1 1/2% per month depending on the dollar amount of the loan, term limitations exist State S & L Associations, and banks may charge 1 1/2% per month on second lien loans.	Actual

STATE	INTEREST CEILING	ACTUAL OR POTENTIAL PROBLEM FOR HIL PROGRAM
13. Idaho	18% 19/ for supervised financial organizations making consumer loans.	Potential
14. Illinois	a. No limit until 12-31-81. Floating Rate 6/ from 1-1-82.	
	b. 9% add-on (or its equivalent in simple interest) for installment loans of up to $25,000 for a term of 15 yrs. secured by non-purchase money second mortgage on real estate.	
[illegible]. Indiana	a. No limit 19/ for loans of more than $45,000	Potential
	b. 18% 19/ for loans of $45,000 or less "primarily secured by an interest in land.	
16. Iowa	Supervised financial organizations may charge up to 21% on consumer loans. A second mortgage loan is a "consumer loan" under the UCCC.	
17. Kansas	a. 18%. Supervised financial organizations may make "consumer loans" (most second mortgage loans are consumer loans) up to this rate on the unpaid balance	Potential
	b. There is no special rate for second mortgages. Non-supervised lenders subject to floating rate 21/.	
18. Kentucky	a. Floating Rate 5/ on loans of $15,000 or less (18% as of June, 1981).	Potential
	b. No limit on loans in excess of $15,000.	
19. Louisiana	12% 19/. For loans secured by real estate not under the UCCC. By agreement of the parties a real estate secured loan may be made a consumer loan. As such, for loans of over $7,000 18/ interest may be charged up to 21% 19/.	
20. Maine	18% for home improvement loans. On May 7, 1983, interest will revert to 15%.	[illegible]
21. Maryland	16%. Under the Secondary Mortgage Loan Law, this rate is applicable to all lenders and to second mortgages on 1 - 4 family property made for non-business purposes.	Actual
22. Massachusetts	18%. Applies generally to all second mortgage lenders which grant realty loans of more than $1,500 secured by other than a first mortgage on an owner occupied dwelling where the property value is less than $40,000. Criminal usury limit of 20% does not apply to state or federally regulated lenders.	Potential
23. Michigan	Floating Rate 8/ up to 16.5% as authorized by the Home Improvement Finance Act.	Actual
24. Minnesota	Floating Rate 7/ on loans up to $100,000. 16.5% as of June, 1981 Until June 30, 1982, under the Industrial Loan Act, state and national banks and savings banks may make loans up to $35,000 (with term restrictions) at the higher of 12% or a floating rate 8/.	Actual

STATE	INTEREST CEILING	ACTUAL OR POTENTIAL PROBLEM FOR HIL PROGRAM
25. Mississippi	Floating Rate 9/ until 6-30-81 for any mortgage secured by a lien on residential property. 19/ However, loans eligible for purchase by FHLMC are exempt from interest rate ceilings if made by banks, savings banks, trust companies, savings and loans associations and credit unions which are subject to the laws of Mississippi or of the U.S. or by mortgagees approved by FHA, VA or FNMA.	
26. Missouri	1 3/8% per month (16.5% per annum) for second mortgage loans of $2,500 or more secured by residential real estate.	Actual
27. Montana	The greater of 10% or floating rate 10/ on loans up to $150,000 Licensed lenders may make small loans up to $25,000 charging 1 1/2% per month on the unpaid principal balance over $7,500 up to $25,000 19/.	Potential
28. Nebraska	16% 19/. No ceiling if loan is insured, guaranteed, sponsored or participated in, in whole or in part by any agency, department or program of the U.S. or state government.	
29. Nevada	18% 19/. However, there are no statutory limitations on loans made by banks for which there is a commitment to purchase by any federal establishment (including FHLMC).	
30. New Hampshire	No limit for banks, savings banks, federal savings and loan associations or other regulated financial institutions. Under the Second Mortgage Home Loans Act rate is 1 1/2% per month (18% per annum). However, this Act does not apply to those regulated financial institutions listed above.	Potential
31. New Jersey	a. No limit on second mortgage loans of $50,000 or more b. The Banking Commissioner may authorize up to 16% for second mortgage loans of less than $50,000. No limit for loans made by S & Ls, banking institutions or any Department of Housing and Urban Affairs or FHA approved mortgage subsequently purchased by FHA, VA, FHLMA, FNMA, GNMA, FHLMC.	
32. New Mexico	No limit for loans "eligible for purchase" by FHLMC. Such loans are exempt from New Mexico's usury laws.	
33. New York	16%	Actual
34 North Carolina	a. No limit for second mortgage loans of $25,000 or more b. For second mortgage loans of less than $25,000, interest may be charged at the greater of 1 1/3% per month (16% per annum) or floating rate 11/.	Potential
35. North Dakota	a. Floating Rate 12/. b. Licensees under the Consumer Finance Act may charge interest at the rate of 1 1/2% per month (18% per annum) on loans of up to $7,500. Banks may charge interest at 1 1/4% per month (15% per annum) in installment loans of up to $25,000 subject to term limitations.	Potential

STATE	INTEREST CEILING	ACTUAL OR POTENTIAL PROBLEM FOR [illegible] PROGRAM
36. Ohio	No limit for mortgages approved, insured, guaranteed, purchased, or for which an offer or commitment to insure, guarantee or purchase has been received in whole or in part by any agency of the state or federal government, FNMA, or FHLMC.	
37. Oklahoma	a. 45% 18/ for loans in excess of $40,000. b. 18% 19/ for "consumer loans" under the UCCC.	Potential
38. Oregon	a. Under the Consumer Finance Act licensees may lend up to 50,000 and charge up to 19 1/2% per annum on the unpaid principal balance in excess of $5,000 18/. b. 12% for loans secured by residential real estate of $50,000 or less not under the Consumer Finance Act.	Actual
39. Pennsylvania	17.4% for loans subject to the Secondary Mortgage Loan Act	Potential
40. Rhode Island	a. 18% for licensees under the Secondary Mortgage Loan Act b. 21% for banks, savings banks, trust companies, S & Ls, credit unions and loan and investment companies which are exempt from the Secondary Mortgage Loan Act.	
41. South Carolina	a. 18% for second mortgage loans of up to $25,000. b. No limits for second mortgage loans over $25,000	Potential
42. South Dakota	19 1/2% for loans up to $30,000 under the Consumer Loan Act	
43. Tennessee	Floating Rate 13/ not to exceed 18% 19/.	Potential
44. Texas	Floating rate 20/ between 18% - 24%.	
45. Utah	18% 19/	Potential
46. Vermont	a. Floating Rate 14/ b. 18% for certain installment loans for a term not to exceed 8 years.	
47. Virginia	a. No limit for second mortgage loans made by S & Ls 18% for non-regulated lenders.	Potential
48. Washington	Floating Rate 15/	
49. West Virginia	Floating Rate 16/ for loans secured by real property. 14.75% as of June, 1981. Federal S & Ls exempt from usury limits.	Potential
50. Wisconsin	a. 12% 19/ for mortgage loans of over $500 made by S & L associations. b 15% for second lien loans of less than $25,000, unless made by S & L c. 19% for loans in any amount made by licensees under the Precomputed Loan Law.	Actual
51 Wyoming	18% 19/	Potential

FOOTNOTES

1. 5% points above the 12th Federal Reserve Bank Advance Rate

2. 5% over the Federal Reserve Discount Rate

3. 2 1/2% points plus the monthly average of daily yields on outstanding U.S. Treasury Bond issues

4. 2 1/2% points plus the monthly Index of Long Term U.S. Government Bond Yields.

5. Up to 4% in excess of the discount rate on 90 day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the transaction is consummated or 19%, whichever is less.

6. Interest to rise and fall according to the interest rate set by auctions of 26 week Treasury bills, up to 16.5%.

7. Interest is based upon the monthly index of the FNMA auction yields as computed by FNMA to be computed during any calendar month as equal to the auction yields for the first preceding calendar month rounded off to the next highest quarter of one percent per year

8. At the higher of 12% or 4 1/2% over the discount rate on 90 day commercial paper.

9. The greater of 10% or 5% above the monthly Index of Long Term U.S. Government Bond Yields.

10. Not more than 10% or more than 4% points in excess of the discount rate on 90 day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District, whichever is greater.

11. 5% points plus an annual equivalent to the Federal Reserve discount Rate, whichever is greater.

12. 5 1/2% higher than the maximum rate of interest payable on time deposits maturing in 30 months as defined and authorized by the State Banking Board.

13. 2% points above the most recent weighted average yield of the accepted offers of FNMA's auction for commitments to purchase conventional home mortgages or, if FNMA discontinues the auction, 4% points above the index of Long Term Government Bonds adjusted to a 20 year maturity by the U.S. Department of the Treasury.

14. Average Yield of 3-5 year U.S. Treasury Securities and Moody's Seasoned Corporate Bonds plus 3.25% points

15. The higher of 12% per annum or 4% points above the equivalent coupon issue yield (as published by the Federal Reserve Bank of San Francisco) of the average bill rate for 26 week Treasury bills as determined at the first bill market auction conducted during the preceeding calendar month

16. Set monthly by the Commissioner of Banking. Rate is monthly Index of Long Term U.S. Government Bond Yields + 1 1/2% points ± 1/4% points as a percentage of the loan divided by the number of years may not exceed 1% of the original principal, except the limit is 2% for construction loans.

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

The Mortgage Corporation

Federal Home Loan Mortgage Corporation

Home Improvement Loan Program

PROGRAM SUMMARY

Announcement	For informational purposes, the next HIL offer date and the Required Net Yield will be announced by FHLMC at least two business days preceding the offer day.
HIL Seller Approval	Lenders wishing to participate in this program should obtain applications from the HIL Center in Washington, D.C. Offers will be accepted only from HIL approved Sellers. A nonrefundable application fee of $500.00 is required from all lenders applying for participation in the HIL program.
Offer Procedure	Sellers may submit offers for up to three purchase contracts by telephoning the Mortgage Corporation at (202) 789-2200, between 9 a.m. and 3 p.m. local time in Washington, D.C., on announced offer dates, and giving the contract offer amount(s). When they call Sellers will be informed of the Required Net Yield and maximum offer amounts. All telephone offers will be tape recorded.
Acceptance Procedure	If eligible offers received exceed funds available, the Mortgage Corporation reserves the right to reduce offer amounts. Contracts accepted will be in amounts of not less than $25,000. Sellers will be notified of acceptance by delivery to them of two copies of the Purchase Contract(s), executed by FHLMC. They should immediately execute both copies and return one copy to the HIL Center within 24 hours after receipt.
Delivery	Delivery of loans is mandatory and must be made within 30 days after the purchase contract date of acceptance. A tolerance of the lesser of $5,000 or 10% of the purchase contract amount is established for deliveries under this program. Complete documentation must be delivered with each loan.
Nonmember Fee	There is no fee for members of a Federal Home Loan Bank. A fee of 0.5% of FHLMC's interest in the HIL purchased is deducted from the amount due a nonmember Seller at the time of purchase
Other Fees	None
Amount	Minimum purchase contract amount is $25,000. The aggregate amount of contract(s) accepted may not exceed the currently quoted FHLMC maximum.
Participation Percentage	The Mortgage Corporation will purchase a participation interest of 80% in each eligible HIL
Required Net Yield	The Required Net Yield specified in the purchase contract is the yield to FHLMC. Each loan must have an interest rate which is equal to or greater than the FHLMC Required Net Yield. The only compensation that Seller will receive for servicing the loan will come from the interest in excess of the FHLMC Required Net Yield.
Use of Proceeds	The proceeds of the HIL must be used to finance improvements for energy conservation, solar installation, rehabilitation, modernization or additions to the property. The improvements must constitute a permanent part of the property securing the loan. In addition, part of the proceeds may be used to: – Refinance an existing loan made exclusively for a previous improvement to the property; – Finance reasonable and customary closing costs, and applicable insurance premiums, if requested by borrower.
Security	Each loan must be secured by a lien on the property being improved.
Loan Term	The original term of each HIL must be for either 5, 10 or 15 years. If the HIL amount exceeds $30,000, the original term must be for either 5, 10, 15 or 20 years.
Age of Loan	Each loan must be closed and fully disbursed prior to delivery to the Mortgage Corporation. Also, the improvements financed by the HIL must be completed prior to delivery
Total Financing-To-Value Ratio (TFTV)	Regardless of the method used to estimate value (see requirements on reverse) the maximum TFTV is 90% (computed as the sum of all lien balances outstanding on the property, including the HIL, divided by the property's current estimated market value).
Debt-to-Income Ratio	Total monthly debt payments for all obligations, including the HIL, generally should not exceed 36% of borrower's stable monthly income.
Note Interest Rate	The interest rate of each HIL note must be stated and collected in terms of simple interest and be equal to or greater than the FHLMC Required Net Yield.
Amortization	Monthly principal and interest payments must begin no later than 62 days after final disbursement of the loan. Regular payments in equal amounts must provide for amortization in full by the maturity date.
Loan Instruments	Loans must be closed on FNMA/FHLMC Uniform Instruments-Home Improvement (Note and Mortgage or Deed of Trust) for the jurisdiction in which the property is located. Loans must be closed in Seller's name (as lender) and be a direct loan to borrower
Loan Documentation	FNMA/FHLMC Uniform Instruments, Home Improvement and Energy Loan Application (FHLMC Form 703) and Standard Credit Investigation Report (FHLMC Form 706) are required for all loans. In addition, if applicable, Property Value Analysis Report (FHLMC Form 704) or an appraisal report (FHLMC Forms 70, 72, or 465) and Satisfactory Completion Certificate (FHLMC Form 442) are also required. See reverse for more specific requirements.

FEDERAL HOME LOAN MORTGAGE CORPORATION
HIL CENTER
1776 G Street, N.W
P.O. Box 37248
Washington, D.C. 20013

For additional information please call (202) 789-4816

FHLMC Publication No. 41 1/80

SPECIFIC LOAN REQUIREMENTS

LOAN AMOUNT	PROPERTY TYPE	PROPERTY VALUE FORM		TITLE EVIDENCE	HAZARD INSURANCE	COMPLETION CERTIFICATE
		AFTER IMPROVEMENT VALUE	PRIOR-TO-IMPROVEMENT VALUE			
$15,000 or less	Single Family	Residential Appraisal Report (FHLMC Form 70)	Part III Property Evaluation Section, Standard Credit Investigation Report (FHLMC Form 705) or Property Value Analysis Report (FHLMC Form 704)	Seller warrants to FHLMC that title and HIL lien position is as stated on the borrower's loan application.	Seller must advise borrower of contractual requirement to maintain hazard insurance coverage in an amount sufficient to cover the HIL all superior liens and the coinsurance amount	All improvements, financed by the HIL, must have been completed prior to delivery of the HIL to the Mortgage Corporation.
	2-4 Family	Appraisal Report-Small Residential Income Property (FHLMC Form 72)				
	Condominium* PUD	Appraisal Report-Individual Condominium or PUD Unit (FHLMC Form 465) (Addenda A&B not required)				When the market value estimate is based on the value of the property after completion of the improvements financed by the HIL, a Satisfactory Completion Certificate (FHLMC Form 442) is required.
Over $15,000 but not more than $30,000	Single Family*	Residential Appraisal Report (FHLMC Form 70)	Property Value Analysis Report (FHLMC Form 704) or Residential Appraisal Report (FHLMC Form 70)	Full Title Policy, or Short Form Title Policy, or Attorney's Opinion of Title	Hazard insurance must be maintained in an amount sufficient to cover the HIL all superior liens and the coinsurance amount. Evidence of insurance must be in the HIL file maintained by Seller	
	PUD*	Appraisal Report-Individual Condominium or PUD Unit (FHLMC Form 465)				
	2-4 Family	Appraisal Report-Small Residential Income Property (FHLMC Form 72)	Property Value Analysis Report (FHLMC Form 704) or Appraisal Report-Small Residential Income Property (FHLMC Form 72)			When the market value estimate is based on the value of the property prior to the improvements financed by the HIL, Seller will be required to warrant that Seller's file contains evidence of completion.
Over $30,000 but not more than $60,000	2-4 Family*	Appraisal Report-Small Residential Income Property (FHLMC Form 72)		Full Title Policy or Attorney's Opinion of Title		

*Maximum Loan Amount for this Property Type

Senator LUGAR. Thank you very much, Mr. Brinkerhoff. I appreciate your attempt and that of Mr. Coffman to summarize and I would hope that both of the remaining two witnesses would do likewise. We will try to bring the hearing to a close by 1 o'clock so we'll have some idea of the timeframe for which we are heading. I'd like to call on Mr. Barr now.

STATEMENT OF JAMES C. BARR, EXECUTIVE VICE PRESIDENT AND DIRECTOR, GOVERNMENTAL AFFAIRS DIVISION, THE CREDIT UNION NATIONAL ASSOCIATION

Mr. BARR. Thank you very much, Mr. Chairman. My name is James Barr and I do have a brief oral statement and I would like to have my complete written statement included in the record.

Senator LUGAR. So ordered.

Mr. BARR. CUNA is pleased to have the opportunity to appear here today to testify on S. 1406 and S. 963 involving preemption of State usury ceilings. We appear here in support of the purpose of both S. 1406 and S. 963.

S. 1406 would extend the mortgage approach of Public Law 96–221 to the consumer, business and agriculture loan field with the opportunity for each State to reimpose a usury standard if it so desires. Our association prefers the total, broad preemption S. 1406 would provide. S. 963, on the other hand, would permit any lender to lend at a rate of up to 1 percent above the Fed discount rate—inclusive of surcharges. It is the opinion of the Credit Union National Association that S. 963 is not the most desirable approach. This issue is a critical one for both lenders and borrowers and we are glad that this subcommittee is holding these hearings to explore the need for further congressional action on usury laws. The relief proposed in S. 1406 and S. 963 will aid lenders by having funds available for loans, consumers by having funds available for borrowing, and businesses which rely on the smooth functioning of the credit system.

Congress took a very important action in meaningful deregulation in the passage of Public Law 96–221, the Depository Institutions Deregulation and Monetary Control Act of 1980, which was signed into law on March 31, 1980. Congress established the Depository Institutions Deregulation Committee for the purpose of phasing out deposit interest rate ceilings by March 31, 1986. CUNA strongly supports this step in deregulation. Savers will no longer by law be subsidizing borrowers, but instead will be paid a competitive rate on their savings. Unfortunately, in Public Law 96–221 Congress inadequately dealt with the problem of the other side of a financial institution's balance sheet.

DEREGULATION CREATES COMPETITIVE MARKET

Deregulation means letting the marketplace decide what rates will be paid on savings and charged on loans. The Interagency Task Force on Thrift Institutions concluded in its report that removal of usury ceilings should not result in exorbitant interest rates for consumers if competitive markets exist. We feel that if restrictions are removed which now serve only to curtail consumer lending under certain economic conditions, a rate structure will emerge that will be fair to borrowers. The nature of the credit

union concept assures that our borrowing terms will be reasonable in light of market conditions. And, Mr. Chairman, I have some material I would like to add later for the record that would, I believe, prove that fact. Members of a credit union—with one member, one vote principle—effectively control the lending policies of their board of directors.

The key to deregulation is having an informed consumer. Credit unions are very committed to consumer education.

We feel that informed consumers are in the best position to decide if they should pay a higher rate of interest to obtain a consumer loan or whether they should wait until rates are lower or until they have saved the money. We question if the role of government—Federal or State—should be to tell consumers that they cannot get credit because it costs too much.

Unlike national banks and federally chartered savings and loan associations, Federal credit unions are subject to a Federal usury law. If S. 1406 were enacted into law without title III, all other competing financial institutions would be given the authority to decide what their lending ceilings would be, but Federal credit unions would remain subject to usury constraints.

In conclusion, credit unions are not seeking Federal preemption of State usury laws on consumer loans so that we can charge exorbitant rates on consumer loans. The very nature of the credit union concept safeguards from unreasonable rates. However, meeting the challenges presented by today's economic conditions requires relief from anachronistic lending rate ceilings. Even the best-managed credit union cannot survive the pressures of the repeated waves of high inflation and interest rates we have experienced in the recent years without the flexibility to adjust its lending and borrowing policies to market conditions. As we move into the 1980's, facing a world where financial institutions will compete for the saver's dollar, we need the authority to decide what lending rates are appropriate to charge borrowers.

As we mentioned earlier in our statement, passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 laid the groundwork for letting the market set the rate on what consumers could earn on their savings. This step was taken by the Federal Legislature. And this action, like many others taken by Congress, affects the balance sheets of all financial institutions regardless of whether they are State or federally chartered. Certainly then, it is appropriate for the Congress to take whatever steps necessary to balance the lending side of the ledger of these institutions.

The Credit Deregulation and Availability Act of 1981, S. 1406, introduced by you, Senator Lugar, brings the saving and borrowing side of a financial institution ledger back into balance. S. 1406 also takes the issue of a State's right to regulate loan ceilings into account by providing for a State to override the provisions of this legislation.

Further, by removing the Federal usury ceiling on credit union loans the Congress is clearly communicating its commitment to total deregulation to the States as well as the financial community. Clearly it is the long term best interest of the Nation's savers and the financial community to let the free market set the rate on

what borrowers must pay and what these same borrowers, as savers, can earn.

CUNA concurs with NCUA board member Harold Black's assessment of the current usury situation as it affects Federal credit unions. In his letter to Senator Lugar supporting S. 1406, Dr. Black stated:

> During the past two years, the Federal usury ceiling has become a pervasive problem within the credit union industry. At times, the cost of funds has exceeded the usury ceiling which has forced credit unions to cease lending activity or to make loans at a loss. The removal of the ceiling on credit union loans will provide a permanent solution to this problem * * *. It is time usury ceilings were eliminated.

Thank you very much, Mr. Chairman, for giving us the opportunity to appear here, and we would be glad to answer any questions.

[Complete statement follows:]

TESTIMONY OF

JAMES C. BARR

EXECUTIVE VICE PRESIDENT AND

DIRECTOR, GOVERNMENTAL AFFAIRS DIVISION

OF THE

CREDIT UNION NATIONAL ASSOCIATION, INC.

Mr. Chairman and members of the Subcommittee, my name is James C. Barr. I am the Executive Vice President and Director of the Credit Union National Association, Inc. (CUNA) Governmental Affairs Division. CUNA is pleased to have the opportunity to appear here today to testify on S.1406 and S.963 involving preemption of state usury ceilings. We appear here in support of the purpose of both S.1406 and S.963.

S.1406 would extend the mortgage approach of P.L. 96-221 to the consumer, business and agriculture loan field with the opportunity for each state to reimpose a usury standard if it so desires. Our association prefers the total, broad preemption S.1406 would provide. S.963, on the other hand, would permit any lender to lend at a rate of up to 1% above the Fed discount rate (inclusive of surcharges). It is the opinion of the Credit Union National Association that S.963 is not the most desirable approach. This issue is a critical one for both lenders and borrowers and we are glad that this Subcommittee is holding these hearings to explore the need for further Congressional action on usury laws. The relief proposed in S.1406 and S.963 will aid lenders by having funds available for loans, consumers by having funds available for borrowing, and businesses which rely on the smooth functioning of the credit system.

THE CREDIT UNION NATIONAL ASSOCIATION, INC. (CUNA) IS AN ASSOCIATION OF CREDIT UNION LEAGUES, REPRESENTING EACH STATE, THE DISTRICT OF COLUMBIA AND PUERTO RICO. THROUGH THE LEAGUES, CUNA REPRESENTS APPROXIMATELY 22,000 FEDERALLY AND STATE CHARTERED CREDIT UNIONS WHICH SERVE MORE THAN 44 MILLION MEMBERS. CREDIT UNIONS ARE COOPERATIVE, NON-PROFIT ASSOCIATIONS THAT OFFER VARIOUS FINANCIAL SERVICES TO THEIR MEMBERS.

PREEMPTION IS NOT AN "ANTI-CONSUMER" ACTION

It is much too simplistic to say that the question of preemption of state usury laws for consumer loans is a consumer versus a business issue. A credit union is a very unique type of financial institution which combines a business orientation with a consumer orientation. We are non-profit, member-owned cooperatives, limited to whom we can serve by a well-defined common bond such as employment or association. Each member of a credit union has one vote in control of the credit union, no matter how many shares the individual holds. Volunteer service is essential to the operation of a credit union; directors, members of the credit committee, and most officers cannot, by law, be compensated. A credit union is therefore a consumer financial cooperative. The Federal Credit Union Act passed in 1934, declared as its purpose "to make more credit available to people of small means for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States."

Credit union members control the decisions of the credit union as to loan rates charged -- up to the legal maximum --

through their elected board of directors which can be replaced if the members do not feel the board is acting in their best interests. A credit union's members could theoretically instruct its board that no consumer loans could be made above 6%. However, the members recognize that the credit union is made up not only of member/borrowers, but also of member/savers. Lending is only one part of the credit union's purpose. The other major purpose is to promote thrift.

The removal of usury ceilings on consumer loans should not be seen as an "anti-consumer" action. As the recent history of 1978-1980 for federal credit unions demonstrated, restrictive usury ceilings only result in fewer (or no) funds being available for consumer loans. Some might view this as "consumer protection" -- the reason usury laws were originally enacted -- but the consumer is being "protected" by telling him that he cannot decide for himself if he is willing to pay for the higher cost of money by paying a higher interest rate. Prohibitive usury ceilings only guarantee that under certain market conditions, financial institutions which need to cover operating costs and pay savers for the use of their funds, will be forced to curtail their consumer lending and look for other

uses of funds such as for loans with more flexible rate ceilings or for investments such as U.S. government securities which can be responsive to current market conditions.

We support the recommendation made in "The Report of the Interagency Task Force on Thrift Institutions." The Task Force in its June 30, 1980 report to Congress recommended:

> "...that Congress give serious consideration to an override of state ceilings on rates charged on secured and unsecured cash loans, credit card transactions, overdraft loans, and other similar forms of consumer lending."

As the background chapter of the report indicated, whenever market rates exceed usury ceilings, lower-income and higher risk borrowers generally have been unable to obtain consumer loans, and because it is more costly to make a smaller loan, small borrowers, whether good credit risks or not, may be cut off completely from credit.

The report also noted that the presence of usury ceilings may have a depressive effect on the economies of states with binding ceilings. The report concludes that on balance

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elimination of consumer loan usury ceilings would be beneficial to the public because such ceilings may only reduce the availability of funds. S.1406 allows the individual states the option to decide that the federal preemptive action is not in the public interest and to reinstate state usury laws. S.963, however, would help lending institutions in states where there is currently a 10% usury ceiling.

PREEMPTION IS CONSISTENT WITH DEREGULATION

Congress took a very important action in meaningful deregulation in the passage of P.L. 96-221, the "Depository Institutions Deregulation and Monetary Control Act of 1980", which was signed into law on March 31, 1980. Congress established the Depository Institutions Deregulation Committee for the purpose of phasing out deposit interest rate ceilings by March 31, 1986. CUNA strongly supports this step in deregulation. Savers will no longer by law be subsidizing borrowers, but instead will be paid a competitive rate on their savings. Unfortunately in P.L. 96-221 Congress inadequately dealt with the problem of the other side of a financial

institution's balance sheet. Title V, Part C, covering preemption of state usury ceilings for "other loans", including consumer loans, did not supply credit unions with the necessary flexibility to deal in a world without deposit interest rate controls. The authority granted is only 1% above the Federal Reserve's discount rate, a rate which often times does not reflect market conditions. We feel S-1406 represents very positive commitment towards deregulation since it would be left to individual financial institutions to determine how to price consumer loans.

Deregulation means letting the marketplace decide what rates will be paid on savings and charged on loans. The Interagency Task Force on Thrift Institutions concluded in its report that removal of usury ceilings should not result in exorbitant interest rates for consumers if competitive markets exist. We feel that if restrictions are removed which now serve only to curtail consumer lending under certain economic conditions, a rate structure will emerge that will be fair to borrowers. The nature of the credit union concept assures that our borrowing terms will be reasonable in light of market conditions. Members of a credit union -- with the one member,

[illegible] effectively control the lending policies of [illegible]

I [illegible] financial institutions the [illegible] annual fees and transaction fees on open-end [illegible] brought about [illegible] charges [illegible] forced them to [illegible] and the Consumer [illegible] Act of 1981 has not encouraged them to [illegible] consumer credit expansion. [illegible] charges and access fees are additional means of [illegible]. Such charges will force consumers to [illegible] whether they really need all the credit cards they have if each card is going to cost them an annual maintenance fee. Consumers will start to think twice about charging for a purchase if there is a transaction fee. An individual lender may find such charges a straight forward way of recouping expenses, but in the long run may decide that the imposition of such fees only serves to discourage the use of a credit card or line of credit. On balance, if the Congress is going to preempt state usury laws on consumer loans, it is consistent with efforts of deregulation to leave to individual lenders the decision whether to impose fees. However, we feel that

competitive forces in many instances will result in institutions imposing no fees or in charging less interest if fees are charged up front.

CONSUMER EDUCATION

The key to deregulation is having an informed consumer. Credit unions are very committed to consumer education. Last September CUNA completed a series of "Financial Fitness" seminars as part of our on-going consumer education program, and we have more recently revised our publication, "Using Credit Wisely", which ends with the statement: "Used with restraint and kept under control, credit adds much to the quality of life. Out of control, it can spell disaster." If, for instance, Congress decides to override state laws prohibiting fees, it is important for the consumer to realize that the fee is an additional cost.

We feel that informed consumers are in the best position to decide if they should pay a higher rate of interest to obtain a consumer loan or whether they should wait until rates are lower or until they have saved the money. We question if the role of government -- federal or state -- should be to tell consumers that they cannot get credit because it "costs

too much." As mentioned above, the results of high money market rates today is to reduce the amount of funds available for loans subject to unrealistically low usury ceilings.

The Federal government has taken a role in consumer education by enacting certain disclosure laws. Although the myriad of disclosure laws have not always been welcomed by financial institutions because they are often unnecessarily complex and costly to comply with (costs which must ultimately be borne by the consumer), we feel disclosure laws add the necessary safeguard for Congress to act to preempt all consumer usury laws.

TITLE III OF S.1406

Unlike national banks and federally-chartered savings and loan associations, Federal credit unions are subject to a Federal usury law. Between 1934 and 1980 the ceiling was 12% per year for any and all types of loans. In 1934 this ceiling provided a great degree of flexibility for credit unions but by 1978 and 1979 credit unions were suffering large outflows of funds and could not make many consumer loans due to inflationary pressures.

As part of P.L. 96-221 Congress granted relief to federal credit unions by raising the ceiling to 15% a year and giving the National Credit Union Administration, the agency which regulates federal credit unions, authority to increase this rate "if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threatened the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth..." While this approach was better than no action by Congress for relief in early 1980, we do not think that a federal administrative agency should have to make such a politically-charged decision on what should be a business decision by each credit union. If S.1406 were enacted into law without Title III, all other competing financial institutions would be given the authority to decide what their lending ceilings would be, but Federal credit unions would remain subject to usury constraints.

CONCLUSION

In conclusion, credit unions are not seeking Federal preemption of state usury laws on consumer loans so that we can

charge exorbitant rates on consumer loans. The very nature of the credit union concept safeguards from unreasonable rates. However, meeting the challenges presented by today's economic conditions requires relief from anachronistic lending rate ceilings. Even the best-managed credit union cannot survive the pressures of the repeated waves of high inflation and interest rates we have experienced in the recent years without the flexibility to adjust its lending and borrowing policies to market conditions. As we move into the 1980s, facing a world where financial institutions will compete for the saver's dollar, we need the authority to decide what lending rates are appropriate to charge borrowers.

As we mentioned earlier in our statement, passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 laid the groundwork for letting the market set the rate on what consumers could earn on their savings. This step was taken by the Federal legislature. And this action, like many others taken by Congress, effects the balance sheets of all financial institutions regardless of whether they are state or federally-chartered. Certainly then, it is appropriate for the Congress to take whatever steps necessary to balance the

lending side of the ledger of these institutions.

The Credit Deregulation and Availability Act of 1981 (S.1406), introduced by Senator Lugar, brings the saving and borrowing side of a financial institution ledger back into balance. S.1406 also takes the issue of a state's right to regulate loan ceilings into account by providing for a state to override the provisions of this legislation.

Further, by removing the federal usury ceiling on credit union loans the Congress is clearly communicating its commitment to total deregulation to the states as well as the financial community. Clearly it is the long term best interest of the nation's savers and the financial community to let the free market set the rate on what borrowers must pay and what these same borrowers, as savers, can earn.

Mr. Chairman, the Credit Union National Association appreciates this opportunity to be heard on this issue, to endorse S.1406, and to urge a speedy enactment regarding this important matter.

Senator LUGAR. Thank you very much, Mr. Barr.
Mr. Dwyer, would you please proceed?

STATEMENT OF VERNON J. DWYER, SECRETARY OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS AND MANAGER OF THE PENTAGON FEDERAL CREDIT UNION

Mr. DWYER. Thank you, Mr. Chairman. I am Vernon Dwyer, secretary of the National Association of Federal Credit Unions and manager of Pentagon Federal Credit Union in Arlington, Va. I also am a member of the Federal Reserve Board's Thrift Advisory Council.

I very much appreciate the opportunity to testify on S. 963 and S. 1406, the Credit Deregulation and Availability Act of 1981. I would also like to comment on the general economic conditions affecting credit unions in this country today that necessitate this form of legislation.

The National Association of Federal Credit Unions has traditionally opposed all ceilings and floors set on the cost of funds. Our members, meeting in caucus last January, reaffirmed NAFCU's long-standing position that the marketplace, unhampered by Government regulation, should establish the rate charged on loans, as well as the dividends paid to savers.

Philosophically, consumer usury ceilings are a remedy of the past. In a volatile financial market, the value of such ceilings is outweighed by the need for flexibility to meet borrowers' legitimate requests for loans. Artificial usury ceilings distort financial markets and, instead of protecting the unwary borrower from the perils of the marketplace, force them to other lenders where they may face usurious interest rates.

During the decade of the 1960's, the prime lending rate changed only 15 times. In 1980 alone, this same rate has changed 60 times. Such radical volatility of interest rates requires a reexamination of the wisdom of perpetuating consumer usury ceilings.

TOTAL PREEMPTION

Senators Bumpers and Pryor, the authors of S. 963, should be commended for their efforts to alleviate some of the problems created by restrictive usury laws. However, we feel that a total preemption, as provided for in S. 1406, would better serve the needs of credit unions and their member-owners.

The Credit Deregulation and Availability Act of 1981 proposes the Federal preemption of State usury ceilings as well as the abolition of the Federal ceiling on lending rates charged by Federal credit unions. We applaud the authors of this bill for including in it the elimination of the one Federal usury ceiling that is solely within the jurisdiction of the Federal Government. This bill would give the boards of directors of individual Federal credit unions the freedom to establish interest rates on loans.

In light of the unique nature of credit unions, this proposal appears to be quite appropriate. As member-owned cooperatives, credit unions hold a unique position in the world of financial institutions. Following a congressional mandate that credit unions provide credit to their members "for provident or productive purposes," many of our Nation's citizens have grown to rely upon their credit unions for loans.

Member-owners of credit unions elect their own boards of directors and these individuals are accountable to the membership. The

preemption of these ceilings would give credit unions the opportunity to be more responsive to the needs of their members in a timely manner, free of the generally well-intentioned but often excessively heavy hand of Government.

I would also note that the personal savings rate in this country has been declining steadily since 1973. Failure of financial institutions to pay market rates on savings has contributed significantly to this decline. The only way to pay market rates on funds is to charge market rates on loans. Restrictive usury ceilings prevent this from happening. These now counterproductive laws were originally designed to protect consumers; they now serve to hinder both borrowers and lenders and distort the flow of funds in the marketplace.

As Senator Garn, an original cosponsor of the Credit Deregulation and Availability Act of 1981 remarked in his introductory floor statement on June 22, 1981:

> It is inherently obvious that financial institutions will never be able to pay market rates on their deposit accounts if they are not permitted to charge market rates for credit.

Chairman Garn went on to say that:

> Enactment of this bill will free up the credit market for consumers with all types of needs * * *. First, it permits the market to establish the rate that is charged by federal credit unions by removing the federal rate that is contained in the Federal Credit Union Act. It makes infinite sense for the Congress to begin by eliminating the one usury ceiling that is solely within our own jurisdiction.

In these times of economic hardship, credit unions and other consumer lenders need the freedom to establish their own rates so that they can best serve their members. Therefore, we recommend prompt adoption of S. 1406 as a long-term solution to the usury problem and urge this Subcommittee to give total preemption a favorable verdict.

Thank you very much for the opportunity to present the views of the National Association of Federal Credit Unions. I will be happy to respond to any questions you might have.

[Complete statement follows:]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Mr. Chairman, I would like to take a few minutes to [illegible] the position of the National [illegible] Credit Unions regarding legislative and [illegible] in setting the price of money. [illegible]

all ceilings and [illegible]

for example, [illegible]

the parallel [illegible]

NAFCU members, meeting in caucus last January, reaffirmed our long-standing position that the marketplace, unhampered by government regulation, should establish the rate charged on loans, as well as the dividends paid to savers.

USURY CEILINGS - A REMEDY OF THE PAST

The last Congress, enacting the "Depository Institutions Deregulation and Monetary Control Act of 1980" (P.L. 96-221), noted that "all depositors, and particularly those with modest savings, are entitled to receive a market rate of return." Total deregulation of the saving side of the ledger is required "as soon as it is economically feasible for depository institutions to pay such a rate." Total elimination of all ceilings on savings rates is scheduled to take place on or before March 31, 1986. Therefore, it is totally appropriate for this Congress to consider and act in a similar manner regarding the borrowing side of the balance sheet.

Philosophically, consumer usury ceilings are a remedy of the past. In a volatile financial market, the value of such ceilings is outweighed by the need for flexibility to meet borrowers' legitimate requests for loans. Artificial usury ceilings distort financial markets and, instead of protecting the unwary borrower from the perils of the marketplace, force them to other lenders where they may face usurious interest rates.

The pressure of higher interest rates is not limited to lending activities. During the past two years, we have seen a

revolution in the rate of return demanded by savers. They have asked for and received, through a variety of new savings instruments, near market rates of return on their savings. During 1979, for example, a dramatic shift in funds occurred at Federal credit unions from lower paying share accounts to higher paying share certificate accounts. Statistics released by the National Credit Union Administration show that during 1979, regular share account deposits which pay up to 7% to the consumer declined by 17.8%. At the same time, share certificates, paying as much as double that rate, increased by 420.5%. By year end 1980, regular share accounts comprised 71.9% of total savings at Federal credit unions. This compares to 95% of total savings in regular share accounts in 1978.

This shift in deposits to higher paying instruments demands that credit unions have the flexibility to charge higher rates on loans. A usury ceiling that prohibits credit unions from charging market rates on loans, limits their ability to offer attractive savings instruments.

During the decade of the 1960s, the prime lending rate changed only fifteen times. In 1980 alone, this same rate has changed sixty times. Such radical volatility of interest rates requires a re-examination of the wisdom of perpetuating consumer usury ceilings.

CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981

The "Credit Deregulation and Availability Act of 1981" (S. 1406) proposes the federal preemption of state usury ceilings as well as the abolition of the federal ceiling on lending

rates charged by Federal credit unions. While we endorse the preemption of all ceilings, we particularly applaud Senator Lugar for including in Title III of his bill the elimination of the one federal usury ceiling that is solely within the jurisdiction of the federal government. Senator Lugar's bill would give the boards of directors of individual Federal credit unions the freedom to establish interest rates on loans. Enactment of S. 1406 without this provision would unfairly hamper credit unions chartered by the federal government in their efforts to meet their members' borrowing needs. Given the concerns of the institutions represented by the National Association of Federal Credit Unions, I shall restrict my comments to Title III of S. 1406.

Federal credit unions are the only class of financial institution governed by a federal consumer usury ceiling. The "Depository Institutions Deregulation and Monetary Control Act of 1980" set this ceiling at 15%, giving the National Credit Union Administration Board the authority to raise this ceiling when economic conditions warrant. S. 1406 would abolish this ceiling and repeal the NCUA Board's rate-setting authority. The boards of directors of Federal credit unions would be responsible and accountable for setting their own loan rates.

In light of the unique nature of credit unions, this proposal appears to be quite appropriate. As member-owned cooperatives, credit unions hold a unique position in the world of financial institutions. Following a Congressional mandate that credit unions provide credit to their members "for provident

or productive purposes," many of our nation's citizens have grown to depend upon credit unions for loans.

Member-owners of credit unions elect their own boards of directors and these individuals are accountable to the membership. The preemption of these ceilings would give credit unions the opportunity to be more responsive to the needs of their members in a timely manner, free of the generally well-intentioned but often excessively heavy hand of government.

On the whole, usury ceilings appear to be having an adverse effect on both lenders and borrowers. When market interest rates rise above the ceilings, the supply of credit diminishes and low-income, high-risk borrowers are unable to obtain loans from regulated lenders. At the same time, depositors are treated unfairly as the ceilings impede the payment of fair interest rates on deposits.

The personal savings rate in this country has been declining steadily since 1973. Failure of financial institutions to pay market rates on savings has contributed significantly to this decline. Other methods of investment are increasing in popularity as traditional financial institutions are losing their power to lend. The only way to pay market rates on funds is to charge market rates on loans. Restrictive usury ceilings prevent this from happening. These now counterproductive laws were originally designed to protect consumers; they now serve to hinder both borrowers and lenders and distort the flow of funds in the marketplace.

As Senator Garn, an original cosponsor of the "Credit Deregulation and Availability Act of 1981" remarked in his introductory floor statement on June 22, 1981: "It is inherently obvious that financial institutions will never be able to pay market rates on their deposit accounts, if they are not permitted to charge market rates for credit." (127 Congressional Record 95 at S 6629.)

The National Credit Union Administration has the authority to raise the prescribed 15% ceiling on loan rates when economic conditions warrant such an increase. As testimony to the inadequacy of the statutory 15% ceiling in the context of today's economic conditions, NCUA raised that rate to 21% several months ago and on June 29, 1981, extended this 21% rate to June 3, 1982. On that date, the rate will, without further action by NCUA or the Congress, revert to 15%. The usury ceiling increase necessitated by market activities gives further evidence of the failure of artificial usury ceilings to accomplish their desired objectives. Chairman Garn went on to say that "Enactment of this bill will free up the credit market for consumers with all types of needs .... First, it permits the market to establish the rate that is charged by Federal credit unions by removing the federal rate that is contained in the Federal Credit Union Act. It makes infinite sense for the Congress to begin by eliminating the one usury ceiling that is solely within our own jurisdiction." (127 Congressional Record 95 at S 6629.)

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S. 963

Senators Bumpers and Pryor should be commended for their work in trying to eradicate the injustices of government intervention into the financial marketplace. S. 963 attempts to alleviate some of the problems created by usury laws by linking the ceiling to a market rate. While this is much more economically sound than the present fixed rates, we feel that a total preemption would better serve the needs of credit unions and their member-owners.

The volatility of the market would prevent managers from adequately planning financial strategies if a floating or indexed rate should be implemented. Credit unions and other lenders would be thrust into a world of economic uncertainty. Variable rate loans would become a greater risk and institutions would be much more hesitant about offering them. Without being able to plan, financial institutions would be left to ride the waves without any real control over their destinies.

In addition, the apparent discrepancy within Section 523 of Public Law 96-221 involving the "most favored lender" status of federally chartered credit unions appears still unresolved. It has been and remains our opinion that the plain language of the statute allows Federal credit unions the flexbility of invoking "most favored lender" status in determining rates to be charged on loans. However, the National Credit Union Administration Board has rendered a conflicting interpretation and has denied Federal credit unions the benefit of most favored lender status. The confusion surrounding this issue is amply demonstrated

by Senator Bumpers' testimony before this subcommittee last week. At that time he noted that under Public Law 96-221 "we provided that any federally related institution, such as a federally chartered bank or credit union ... could charge one percent above the Federal discount rate on any loan." In light of the confusion surrounding this discrepancy, NAFCU urges this subcommittee to follow the more direct approach of S. 243 in preempting these usury ceilings.

In these times of economic hardship, credit unions and other consumer lenders need the freedom to establish their own rates so that they can best serve their members. Therefore, we recommend prompt adoption of S. 1406 as a long-term solution to the usury problem.

CONCLUSION

In conclusion, Mr. Chairman, I would like to reiterate NAFCU's support for the "Credit Deregulation and Availability Act of 1981" (S. 1406) and commend Senator Lugar and the other distinguished cosponsors of this bill for including among its provisions language dealing with the unique situation confronting Federal credit unions. I urge this Committee to give this preemption a favorable verdict.

Thank you very much for the opportunity to present the views of the National Association of Federal Credit Unions. I will be happy to respond to any questions you might have.

Senator LUGAR. Thank you very much, Mr. Dwyer.

Both you and Mr. Barr have in your testimony outlined the inherent structure of credit unions and, as I reiterate that, please correct me if I'm in error; but essentially you have an election of your board of directors in which each member has one vote, regardless of the amount of the account, and essentially your board of directors is responsible for the loan rates that you charge.

Mr. BARR. Yes, sir.

Mr. DWYER. Yes, sir.

PROTECTION THROUGH MEMBERSHIP

Senator LUGAR. This is an interesting situation. As we have discussed today, the protections to consumers, at least one group of consumers, namely those who are involved with membership of credit unions—the protection comes through the democracy of the form of membership and election of the board and the setting of rates which presumably is going to be in consonance with the desire of members that they are not charged a rate beyond bearing.

How does that work out? What kind of discussions do you have with your board, with your members? Has a case ever come up in which a board says, "We think in order to keep this credit union alive we ought to charge so much for a consumer loan." Has anybody ever disagreed with how high that ought to go?

Mr. DWYER. Most assuredly, in the Pentagon, sir. The board is, in the first instance, limited as to the rate structure by the Federal ceilings that we must live within, but within that, as a member-owned cooperative, the members' interests and the consumer interests are violently and forcefully represented on that board and continuously management is pressured—"Are there any options at all that would preclude us from going to a higher level?"

Senator LUGAR. Well, do you have a further comment, Mr. Barr?

Mr. BARR. Really nothing further, Mr. Chairman, just to elaborate slightly. I have attended many credit union board meetings and I can assure you that probably the one decision that they hate to make above all others is to raise loan rates, and at times you will see decisions made at the board level that would be against the economic best interest of the credit union if they felt it was necessary to make a loan to a member who was in dire need of that loan, and you see them make a loan below market rates.

Senator LUGAR. So in the event S. 1406 should become law and in essence deregulation of this process occurs, you have the right to charge whatever you want to, your checks and balances in that situation are adequate to protect the members? As a matter of fact, the members can change the board?

Mr. DWYER. They can indeed. We would see no way in which the board would be in a runaway position, nor would it wish to.

Mr. BARR. To further illustrate that, Mr. Chairman, I have an item I would like to submit for the record. Public Law 96–221 did raise the Federal usury statute limit from 12 to 15 percent, with the National Credit Union Administration Board, the regulatory agency, having the authority to go above that rate if economic conditions warrant. The current ceiling is 21 percent.

If the arguments heard earlier today are correct, then one would assume that all credit unions are charging the 21-percent ceiling

for loans right now. That is not the case. Statistics provided by the National Credit Union Administration, show that out of 16,121 federally insured credit unions, at the present time there are only 8 at the 21-percent limit.

Interestingly enough, almost 60 percent of the credit unions are still at the old 12-percent ceiling and fully 98 percent are at 15 percent or below. That's of 16,121 credit unions, which indicates pretty well that usury ceilings don't automatically set the floor.

Senator LUGAR. That's a very interesting piece of evidence. Without objection, it will be placed in the record.

[The following table was ordered inserted in the record:]

DISTRIBUTION OF FEDERALLY INSURED CREDIT UNIONS BY MOST COMMON INTEREST RATE CHARGED, 1980

Most common rate in 1980 (percent)	Number of federally insured credit unions	Percent of total	Cumulative percent
9	125	0.8	0.8
9 to 12	317	2.0	2.8
12	9,318	57.8	60.6
12 to 15	881	5.5	66.1
15	5,225	32.4	98.5
15 to 18	92	.6	99.1
18	141	.9	100.0
18 to 21	14	.09	100.1
21	8	.05	100.15
Total	16,121	100	

Senator LUGAR. What has been the rationale of the Credit Union Administration for going to 21 percent? Fifteen is where we were apparently at at the time of the passage of the law last year and you say now the limit is already 21 percent. How would you characterize that activity?

Mr. BARR. Nine months ago the National Credit Union Board acted to go above the 15-percent ceiling to 21 percent. This action was taken at a time when interest rates were very much on the rise. Federal credit unions in particular had been suffering from the lost income that came about during the 12-percent period. After great debate among the three board members as to exactly what rate they should establish, they decided on 21 percent.

Interestingly enough, Mr. Black, who had by letter concurred with you, Mr. Chairman, on your bill, suggested they ought to go to 28.3 percent. He was suggesting a figure that would be well above any ceiling which, in effect, would do away with the ceiling altogether.

Senator LUGAR. Thank you very much. I remember very well the testimony of credit unions during this crisis period when the limit was at 12 percent and the testimony from most of the credit unions from my State was that they would be in jeopardy of termination if changes were not made.

Let me ask those who are most involved with the loaning of money for mortgages, the thrift institutions, the experience as we have seen and the evidence of these hearings is that when controls were taken off of interest rates for home mortgages these instru-

ments did not go out of sight but apparently followed very closely the general flow of interest—the prime rate, for example. There appears to have been enough competition in the market presumably that interest rates in this very important extension of credit were not sent through the ceiling. Has that been your experience broadly as you have taken a look at the national picture as well as your own local situations, and is it predictable that if that has been the case in that portion or one of the portions of the credit market that has been deregulated in which controls have been taken off that that would be the case with consumer finance? Would you offer any testimony in that area?

Mr. COFFMAN. Yes, I might speak from the local area. This gentleman can speak for the national.

In Arkansas, where we enjoy the preemption of usury on residential mortgages, our mortgage rates definitely went into the area of about 1¼ to 1½ percent markup. That's what we call it above our cost of money. So we figured out our cost of doing business, which was about 1.38 percent of our total overall assets and we tried to add that in with the 1¼-percent markup, which then seeks a level. It made a level playing field for the banks and the savings and loans and for the market brokers who were selling in other places.

SHOPPING FOR MORTGAGE RATES

As you said, the marketplace determines what you can get for a mortgage. Those things are shopped for by every real estate dealer in town so as to make the best possible deal to make a sale. It's shopped for by the home builder-seller. It's shopped for by the homebuyers themselves. We have a community of 8,500 people and we'd have 10 to 20 calls each day wanting to know what rates we're charging on home loans at that time, what fees we charge.

As you know, all those things—I heard this testimony here today—the fees are a fact of life. It's a cost to do business. You have to have title opinions. You have to have title insurance. Those folks understand that. There's nothing except the marketplace determining what we can get for our money. If this usury is taken off consumer loans, consumer loans will be shopped for just as mortgage loans. The car dealers, the television, the appliance people—whatever it might be—they are going to be shopping, and lenders need this relief so we can help the merchants survive in a community such as Arkansas. Since I'm from Arkansas I can understand the problems. The money is leaving our State. There's no argument about that. To keep it there, we're going to have to have this relief that this bill would give us, and I thank you for sponsoring the bill and I think we need to get it enacted.

Senator LUGAR. Mr. Brinkerhoff, do you have any comments?

Mr. BRINKERHOFF. Well, I would just add that certainly our experience has been such as you indicated. In our own nationwide programs, we acquire our money in the capital markets at a single national rate and there's certainly no investor in any State of the union who wants to take a lower than market rate to acquire the funds, and that's the case as well on the liability side in any financial institution. Savers want to obtain the highest rate that they can, on their deposits and those are national rates that are prevalent now following the action taken by Congress to deregulate

the rate paid to savers. It's an anachronism on the lending side that some rates are lower due to State usury ceilings. Certainly on the first mortgage side of the equation our own experience was that when usury ceilings were preempted last year that many areas of the country, particularly the Northeastern part of the country, which had been precluded from activity in our program because lenders were not able to pay market rates for their funds, were able to obtain a greatly increased supply of funds and make it available for people in their areas who wanted to purchase homes.

We would expect that same pattern would follow with respect to consumer loans and other kinds of loans that are covered by S. 1406. In fact, the programs offered by the Mortgage Corporation tend to create a kind of national rate for loans by virtue of the very activity that we undertake.

Senator LUGAR. Thank you very much, Mr. Brinkerhoff, and I thank each of you gentlemen for your testimony and response to the questions and your patience in waiting until the end of this extensive hearing, but it has been an interesting hearing and it's the second in this series of hearings on this legislation. The third hearing will occur on the 21st of this month and so we look forward to additional testimony at that time.

Mr. BARR. Mr. Chairman, may I add one other thing to the record?

Senator LUGAR. Yes.

Mr. BARR. I hate to take up your time, but very briefly, I want to express some concern on the part of CUNA to the statements that were made earlier this morning.

CUNA is a charter member of the Consumer Federation of America and there were several things stated by that organization that we do not agree with.

First of all, we do not agree with their position, quite obviously, on usury ceilings, although we work with them very closely on other positions.

Some of the statements they made concerning credit availability we disagree with. For example, in 1979 when Federal credit unions were saddled with a 12-percent usury ceiling. These same credit unions went from the fastest growing segment of the financial community to last place. That was strictly due to the 12-percent usury ceiling that was in effect at that time.

Also, with respect to the statement about bankruptcy, Mr. Connell, the Chairman of the National Credit Union Board, testified yesterday before the House Banking Committee. He stated that their statistics indicate that 53 percent of all consumer bankruptcies are directly a result of the Bankruptcy Reform Act of 1978 and not due to current economic conditions.

I would just like to get these facts into the record, with your permission.

Senator LUGAR. It will be in the record as direct testimony and I appreciate your addition. Thank you very much.

The hearing is adjourned.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981

TUESDAY, JULY 21, 1981

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D. C.

The subcommittee met, at 10:08 a.m., in room 5302 of the Dirksen Senate Office Building, Senator Richard G. Lugar presiding.

Senator LUGAR. Good morning. This third hearing on the usury ceiling question is called to order.

We are hearing witnesses on S. 1406 and S. 963. We are especially pleased to have a distinguished panel to lead off this third hearing this morning: Governor Nancy H. Teeters, Member of the Board of Governors of the Federal Reserve System, and Dr. Harold A. Black, Board Member of the National Credit Union Administration.

Prior to hearing from Governor Teeters and Dr. Black, I would like to take this opportunity to add to the record two statements, testifying to the administration's support of federal preemption of usury ceilings for all loans.

[The information follows:]

DEPARTMENT OF THE TREASURY,
Washington, D.C., May 14, 1981

Hon. RICHARD S. LUGAR,
U.S. Senate,
Washington, D.C.

DEAR SENATOR LUGAR: Secretary Regan asked me to respond to your letter of April 27th regarding the Secretary's position on Federal preemption of state usury ceilings. In his testimony before the Senate Banking Committee on April 28th, the Secretary stated that, in his opinion, usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit in the economy. He favors preemption of usury ceilings for all loans in the manner prescribed in the Deregulation Act.

In your letter you also asked for the Secretary's comments on H.R. 2501, which deregulates interest rate ceilings on business, agriculture and consumer credit transactions. The Secretary supports the approach of this bill but feels that the experts on truth in lending and consumer safeguards at the Office of the Comptroller of Currency, whom you have also asked to address this issue, are better qualified to comment on the adequacy of the drafting of the bill, particularly in regard to the sufficiency of the consumer safeguards.

Sincerely,

W. DENNIS THOMAS,
Assistant Secretary
(Legislative Affairs).

TESTIMONY OF HON. DONALD T. REGAN, SECRETARY OF THE TREASURY

Mr Chairman and members of this distinguished Committee, I appreciate this opportunity to review with you the current economic and competitive conditions in our financial markets. I am also eager to join you in examining the major banking and consumer laws enacted by Congress in recent years. There has been a lot of legislation and this is a good time to review its impact and effectiveness, while the strengths and weaknesses of our financial markets are being tested by high inflation and high interest rates.

As you know, the Treasury Department directly administers only a few provisions of the recent legislation Most of our responsibilities are implemented through the Office of the Comptroller of the Currency, and since the Comptroller and the other regulators will be testifying on their own behalf, I will let them deal with the more technical features of the legislation.

I would like to focus my comments on how we should be structuring and modernizing our depository institutions for the future with these objectives in mind. Every action we take must be in the best interests of the public as consumers of financial services. The Administration and the Congress share the responsibility to resist protecting the parochial interests of some institutions. We must place greater reliance on market forces to determine the character and structure of our financial system We must build a strong and competitive framework that will give our institutions the flexibility to respond to a changing financial environment with the best and most varied financial services for years, indeed, for decades to come.

FINANCIAL MARKET CONDITIONS

Despite enormous inflationary pressures our financial markets and financial institutions have generally been performing well. The one problem area involves thrift institutions (savings and loan associations and mutual savings banks) and to a lesser extent small commercial banks whose primary business is financing housing. These institutions have structural problems in their asset and liability portfolios that make it difficult for them to cope with very high interest rates.

The distortions and uncertainty caused by rapid and variable inflation are forcing thrift institutions to use an increasing amount of short-term deposit liabilities with interest rates that vary with market rates to make long-term mortgage loans or to carry long-term mortgages made in prior years. The remainder of the institutions' deposits are under Federal deposit interest rate ceilings and have rates that vary with market rates only below the ceilings.

However, mnost thrift institution mortgages have fixed interest rates set when the loans were made, often years ago at rates substantially below current market levels. The ratio of variable rate mortgages to total thrift industry loans is much smaller than the proportion of rate sensitive deposits relative to total deposits.

This imbalance between increasingly rate sensitive liabilities and long-term relatively rate insensitive assets is central to the thrift industry's current problems. At present short-term interest rates exceed both the rates on most of the institutions' existing mortgages and the long-term rates on new mortgages (an inverted yield curve). As a result, thrift institutions are paying more for their liabilities than they are earning on their assets, which means they are operating at a loss and thereby eroding their capital

Recent decontrol efforts have not gone far enough in reducing the vulnerability of this industry to short-term interest rates because the Federal government has, unfortunately, removed controls on depository institution liabilities faster than it has decontrolled their asset powers. This action was taken to enable thrift institutions to at least acquire sufficient funds to carry existing assets, i.e., to meet minimum liquidity needs. Actually in 1980 savings and loan associations secured enough deposits and borrowings to increase their assets approximately nine percent and mutual savings banks enough for an increase of over five percent. In the first quarter of this year savings and loan associations had another increase in assets. Figures for mutual savings banks are not yet available

The institutions were less successful in meeting competition from alternative investment instruments with market interest rates in terms of what they regarded as their fair share of available money, although they did not do poorly. In 1980 money market mutual fund assets increased $29.2 billion, while total deposits at insured savings and loan associations gained $41.0 billion and at mutual savings banks $7.8 billion.

The dilemma confronting thrift institutions is how to compete effectively for deposits when short-term interest rates are so high and most of the industry's

assets, old and new, are yielding less than the cost of the deposits. It does little good to acquire funds that can not be profitably employed.

One proposed solution to this dilemma would be to moderate the ability of money market mutual funds to pay high interest rates. Several proposals have been advanced to achieve this objective, but these would penalize the public and not create a competitive balance because even if severe restrictions were enacted to drive investors out of money market funds, they would only seek the highest interest yielding alternative. In our opinion, such restrictions would accelerate the growth of other high rate investment vehicles—Treasury securities, commercial paper, bankers acceptances, etc.—and raise the demand for still more restrictions. Imposing new controls on our financial markets would be the wrong approach to assisting the thrift industry. It would be treating only a symptom of the industry's real illness which is excessive inflation. What the industry needs most at the moment, along with the entire economy, is less inflation and lower short-term interest rates.

Mr. Chairman, we think that the President's economic program will produce lower interest rates, and we think it offers the best possible solution to the thrift industry's problems. The program's balanced tax, budget and monetary policy features are designed to work collectively in reducing the rate of inflation. This, in turn, should lead to lower interest rates and a normal yield curve.

We believe that existing Federal agencies with whom we have been in close contact can deal adequately with any seriously troubled depository institutions that may need special assistance before or after short-term interest rates decline. The Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation regularly deal with institutions that have exceptional problems. Similarly, the Federal Home Loan Bank Board and the Federal Reserve System can provide temporary liquidity to institutions where that is necessary. We will continue to closely monitor the conditions of the thrift industry and will be prepared with alternative approaches to its problems if there is a significant deterioration in its situation.

RESTRUCTURING OF FINANCIAL MARKETS AND FINANCIAL INSTITUTIONS

Now Mr. Chairman, I would like to turn my attention to long term changes in the structure of our financial markets and institutions.

The Depository Institutions Deregulation and Monetary Control Act of 1980 expanded the concept of putting all depository institutions—commercial banks, savings and loan associations, mutual savings banks and credit unions—on an equal competitive footing. We believe this is a desirable objective. It seems that at some point all the institutions must have the same powers to perform the same types of business. The current problems facing thrift institutions are largely the result of prior government attempts to structure an industry by statute in ways that are not economically feasible. We believe all depository institutions should have equal powers and should be free to choose whatever specialization they wish, based on their individual competitive skills and goals. The ultimate beneficiary of this flexibility would be the consumer or other user of depository institution services whose special conveniences could be more readily addressed.

The most pressing need at this time is for further decontrol of asset powers, to enable depository institutions to better utilize the high cost deposits that go with high inflation rates. In this connection, the Comptroller of the Currency recently issued regulations to facilitate the use of rate sensitive mortgages by national banks, and the Federal Home Loan Bank Board last week further liberalized its regulations for rate sensitive mortgages offered by Federal savings and loan associations. Both actions should assist depository institutions financing housing to balance the rate sensitivity of their assets and liabilities.

The Deregulation Act of 1980 authorized all Federally chartered thrift institutions to make consumer loans and savings banks to make commercial loans under certain limited conditions. The Administration favors expansion of these powers to allow all depository institutions to make the same type of loans in whatever amount they see fit. In developing this objective an examination will have to be made of the present tax incentives that encourage thrift industry specialization.

The Deregulation Act of 1980 also preempted state usury ceilings on mortgage and commercial loans, if the state legislatures do not reinstate the ceilings within three years from the effective date of the Act. Had this preemption occurred earlier, many thrift institutions would not have so many low, fixed rate mortgages in their portfolios aggravating their current earnings problems. In our opinion, usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit in the economy. Instead, these ceilings simply alter or hide the cost and result in credit being allocated by non-market criteria. We would favor their preemption for all loans in the manner prescribed in the Deregulation Act.

Decontrol of the liability side of depository institution balance sheets should move in tandem with the expansion of asset powers. On December 31, 1980 all depository institutions were authorized to offer Negotiable Order of Withdrawal accounts. These accounts had previously been available only in New England, New York and New Jersey. In the three months they have been available nationwide NOW accounts have been as popular with the public as they were on a regional basis. Consequently, it seems appropriate to go the next step and authorize all depository institutions to accept demand deposits. The greater availability of consumer and commercial checking accounts should enhance the efficiency of all personal and business transactions as well as competitive equity among depository institutions.

As the new Chairman of the Depository Institutions Deregulation Committee I have a personal opportunity to work with the other Committee members to decontrol interest rate ceilings on deposit accounts. While the phase out of ceilings is likely to take some time, it needs to be accelerated and done in a manner that will assist in easing the problems of thrift institutions. To this end, the Committee already has published for public comment two proposals to decontrol ceilings beginning with longer maturing deposits.

These proposals are intended to allow thrift institutions to be increasingly competitive in seeking longer-term deposits which more nearly match the effective maturities of their long-term assets. In any event, I hope the Deregulation Committee will adopt a schedule that is firm, so depository institutions can prepare for decontrol. Too many previous ceiling changes have been ad hoc. I invite the members of this Committee and everyone else to comment on these proposals.

Mr. Chairman, at a time in the not too distant future while the deregulation of depository institution balance sheets is proceeding, I would like to join with this Committee in examining other aspects of depository institution operations. As these organizations take on expanded powers to conduct the same kinds of business, consideration should be given to modernizing the structure of the markets in which that business takes place. There needs to be an early review of the current laws controlling the interstate and interindustry operations of depository institutions. If the public is to benefit from the increased powers of these organizations and their enhanced ability to compete, the delivery of their services must be as efficient as possible, which may even involve some consolidation of institutions.

In many ways the effectiveness of these highly regulated intermediaries is dependent on the quality and efficiency of Federal supervision. As the powers of the institutions coalesce, it would appear that there could be some reduction in the number of Federal agencies regulating depository institutions. There are currently seven by my count—the Federal Reserve Board, Federal Deposit Insurance Corporation, Comptroller of the Currency, Federal Home Loan Bank Board, National Credit Union Administration Board, Federal Financial Institutions Examination Council and the Depository Institutions Deregulation Committee—the last two of which were created by recent legislation. I hope to eliminate as soon as possible the one of which I have just become chairman. But even six agencies seems to be excessive if our objective is deregulation.

There is an urgency to all this work, Mr. Chairman, because our financial markets are evolving themselves much faster than we in government have responded to changing technology and economic pressures. Instead of furthering the innovations in the market place, government has tended to impede them and has faced change only when it appears as a problem, such as we are experiencing with the thrift industry. Government needs to be more supportive of our free markets and their ability to adapt and to rejuvenate themselves.

The recent legislation we are examining focuses on the relationships among depository institutions. It does not deal very much with the broader issues concerning the relationship of these institutions to other nondepository financial organizations. Yet, mergers in the securities industry in recent weeks suggest the financial markets are doing a lot of structuring of their own that will have implications for depository institutions. At some time, this Committee should broaden its examination of financial markets to look at how depository and nondepository financial businesses relate. I have some very strong personal convictions about the need to reduce legal barriers that separate the activities of all financial institutions in addition to those that enforce or encourage specialization among just depository institutions, but the Administration is not yet prepared with a policy on this broader issue.

Senator LUGAR. Welcome, Governor Teeters. Would you please testify first and then Dr. Black?

STATEMENT OF NANCY H. TEETERS, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Governor TEETERS. I would like to submit my testimony for the record.

I am pleased to appear before the Subcommittee on Financial Institutions to present the Federal Reserve Board's views on two bills—S. 963, a bill to authorize loans at interest rates in excess of certain State usury ceilings, and S. 1406, the Credit Deregulation and Availability Act of 1981. S. 963 would temporarily allow any type of lender to originate loans at a rate of up to 1 percent above the Federal Reserve discount rate. S. 1406 would permanently remove all State limits on interest rates on business, agricultural, and consumer credit and also would preempt State restrictions on transaction and access fees on consumer credit and payment services. Both bills would permit any State to establish its own ceilings by enacting overriding legislation.

S. 963 and S. 1406 would thus broaden the coverage of preemptive actions under the provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980. That act, as you recall, authorized the orderly phaseout and ultimate elimination of interest rate ceilings on deposit accounts. In addition, it permanently preempted State usury laws affecting most first mortgage home loans and temporarily preempted State usury laws governing most business and agricultural loans, permitting lenders to charge a rate of up to 5 percent above the Federal Reserve discount rate. The act also extended to certain financial institutions the authority, previously granted only to national banks, to set rates on all types of loans of up to 1 percentage point above the discount rate. Any State, however, was allowed to override certain of these preemptions.

In many localities during the past few years, rising costs of funds have seriously eroded the profitability of lending at rates permitted by State law. Consequently, the supply of credit in areas with restrictive rate ceilings has at times been curtailed, especially to higher-risk borrowers, as loanable funds obtained at market rates have been channeled to other investments or to geographic areas permitting a more competitive return. These developments have underscored the importance of allowing leeway for financial markets to function without being hampered by artificial constraints on loan rates. With that broad objective in mind, the Board has consistently supported the removal of impediments posed by usury laws. This view, of course, has recently been reinforced by the prospect of the eventual removal of all controls on the rates that banks and thrift institutions can pay for deposits.

RESERVATIONS ABOUT ENDORSING PREEMPTION

Although the Board favors termination of artificial constraints on interest rates, we continue to have reservations about endorsing preemption by the Federal Government of State usury laws. The Board would prefer that the counterproductive effects of usury ceilings be addressed by corrective action at the State level.

However, if the Congress chooses to act, we endorse the inclusion of provisions that would allow individual States override the Federal preemption and that would defer to actions already taken in a

number of States to override the preemptive provisions of the Monetary Control Act. Although S. 963 and S. 1406 would both permit States to supersede Congressional action, only S. 1406 would recognize the binding character of overriding State actions which have been taken since the Monetary Control Act was enacted, but before the effective date of the new legislation.

If the Congress should choose to impose a Federal usury limit rather than to remove interest rate controls altogether, the Board would strongly advise against tying such a ceiling rate to the Federal Reserve discount rate, as would be provided by S. 963. It would be inappropriate, we feel, to employ a tool of monetary policy for a use that is not directly related to policy needs.

The Federal Reserve discount rate, as you know, is the rate of interest charged by Federal Reserve banks on extensions of short-term credit to depository institutions. There are significant restrictions on the amount and the frequency of discount window borrowing by depository institutions. Ordinarily, large institutions with access to national money markets are expected to repay these loans the following business day; smaller institutions that lack such broad market access may require accommodation for somewhat longer periods of time. In any case, the maturity of this special type of borrowing—largely to meet temporary requirements for funds—is ordinarily much shorter than is typical for business, agricultural, or consumer credit. The discount rate thus provides no sensitive indication of the course of interest rates on longer maturity credits.

Another reason why the discount rate is inappropriate for indexing is that it is an administered rate which reflects frequently complex general policy considerations. As a result, it deviates fairly often from other market interest rates, even those of comparable maturity. Tying the usury limit to the Federal Reserve discount rate would thus increase the likelihood that a statutory ceiling might at times be below market interest rates, thus constraining the availability of credit subject to the usury law. That is especially the case in consumer lending, where going rates at any one time typically range widely depending on loan size, collateral, if any, and other determinants of credit risk.

BOARD RELUCTANT TO ASSUME INTERPRETATIONS

Also of concern to the Board is that Title II of S. 1406 would authorize and direct the Federal Reserve to publish official interpretations about the scope and the application of the consumer credit preemption provisions of the act. The Board recognizes that these rulings could help resolve uncertainties about the relationship of the Federal law to State usury laws. Even so, it is unclear whether the benefits accruing to the public from these interpretive rulings would outweigh the costs of the additional paperwork and the administrative apparatus that would be required. Moreover, the Board is reluctant to assume the role of interpreting these legal relationships and of resolving possible statutory conflicts. These are functions primarily of a judicial character that, in the Board's opinion, should remain within the purview of the courts wherever possible. They are far removed from the Board's primary responsibility for formulation of monetary policy.

Another special feature of S. 1406 is the removal of State controls on periodic fees associated with credit card or debit card accounts as well as transaction charges for credit cards or payment mechanism services. As in the case of interest rate ceilings, the Board favors the determination of such fees and charges by market forces. The prohibition in some states of account or transaction fees on credit card accounts has allowed customers who pay in full by the end of the billing cycle to use credit services without paying for them. Permitting transaction and access fees in such instances makes economic sense because these charges enable creditors to allocate costs in accordance with the usage of specific services. However, the Board believes that, where necessary, corrective action at the State level would be the most desirable way to address any counterproductive effects of limitations on these fees and charges.

To summarize, the Board supports attempts to remove ceilings that can constrain the price of business, agricultural, and consumer credit. It also supports efforts to eliminate controls on fees that may be charged in connection with consumer credit accounts and services. The Board continues to feel, however, that state action rather than federal law should prevail whenever possible in governing pricing policies of these kinds. In view of the large and rapid recent changes in the underlying determinants of the cost and the availability of credit, appropriate action at the State level has become all the more imperative.

[Complete statement follows:]

Statement by

Nancy H. Teeters

Governor, Board of Governors of the Federal Reserve System

I am pleased to appear before the Subcommittee on Financial Institutions to present the Federal Reserve Board's views on two bills--S.963, a bill to authorize loans at interest rates in excess of certain state usury ceilings, and S.1406, the Credit Deregulation and Availability Act of 1981. S.963 would temporarily allow any type of lender to originate loans at a rate of up to 1 percent above the Federal Reserve discount rate. S.1406 would permanently remove all state limits on interest rates on business, agricultural, and consumer credit, and also would preempt state restrictions on transaction and access fees on consumer credit and payment services. Both bills would permit any state to establish its own ceilings by enacting overriding legislation.

S.963 and S.1406 would thus broaden the coverage of preemptive actions under the provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980. That Act, as you recall, authorized the orderly phase-out and ultimate elimination of interest rate ceilings on deposit accounts. In addition, it permanently preempted state usury laws affecting most first mortgage home loans, and temporarily preempted state usury laws governing most business and agricultural loans, permitting lenders to charge a rate of up to 5 percent above the Federal Reserve discount rate. The Act also extended to certain financial institutions the authority, previously granted only to national banks, to set rates on all types of loans of up to one percentage point above the discount rate. Any state, however, was allowed to override certain of these preemptions.

In many localities during the past few years, rising costs of funds have seriously eroded the profitability of lending at rates permitted by state law. Consequently, the supply of credit in areas with restrictive rate ceilings has at times been curtailed, especially to higher-risk borrowers, as loanable funds obtained at market rates have been channeled to other investments or to geographic areas permitting a more competitive return. These developments have underscored the importance of allowing leeway for financial markets to function without being hampered by artificial constraints on loan rates. With that broad objective in mind, the Board has consistently supported the removal of impediments posed by usury laws. This view, of course, has recently been reinforced by the prospect of the eventual removal of all controls on the rates that banks and thrift institutions can pay for deposits.

Although the Board favors termination of artificial constraints on interest rates, we continue to have reservations about endorsing preemption by the federal government of state usury laws. The Board would prefer that the counter-productive effects of usury ceilings be addressed by corrective action at the state level. However, if the Congress chooses to act, we endorse the inclusion of provisions that would allow individual states to override the federal preemption, and that would defer to actions already taken in a number of states to override the preemptive provisions of the Monetary Control Act. Although S.963 and S.1406 would both permit states to supersede Congressional action, only S.1406 would recognize the binding character of overriding state actions which had been taken since the Monetary

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Control Act was enacted but before the effective date of the new legislation.

If the Congress should choose to impose a federal usury limit rather than to remove interest rate controls altogether, the Board would strongly advise against tying such a ceiling rate to the Federal Reserve discount rate, as would be provided by S.963. It would be inappropriate, we feel, to employ a tool of monetary policy for a use that is not directly related to policy needs.

The Federal Reserve discount rate, as you know, is the rate of interest charged by Federal Reserve banks on extensions of short-term credit to depository institutions that are subject to significant restrictions on the amount and the frequency of their discount window borrowing. Ordinarily, large institutions with access to national money markets are expected to repay these loans the following business day; smaller institutions that lack such broad market access may require accommodation for somewhat longer periods of time. In any case, the maturity of this special type of borrowing--largely to meet temporary requirements for funds--is ordinarily much shorter than is typical for business, agricultural, or consumer credit. The discount rate thus provides no sensitive indication of the course of interest rates on longer maturity credits.

Another reason why the discount rate is inappropriate for indexing is that it is an administered rate which reflects frequently complex general policy considerations. As a result, it deviates fairly often from other market interest rates, even those of comparable maturity. Tying the usury limit to the Federal Reserve discount rate would thus increase the likelihood that a statutory ceiling might at

times be below market interest rates, thus constraining the availability of credit subject to the usury law. That is especially the case in consumer lending, where going rates at any one time typically range widely depending on loan size, collateral (if any), and other determinants of credit risk.

Also of concern to the Board is that Title II of S.1406 would authorize and direct the Federal Reserve to publish official interpretations about the scope and the application of the consumer credit preemption provisions of the Act. The Board recognizes that these rulings could help resolve uncertainties about the relationship of the federal law to state usury laws. Even so, it is unclear whether the benefits accruing to the public from these interpretive rulings would outweigh the costs of the additional paperwork and the administrative apparatus that would be required. Moreover, the Board is reluctant to assume the role of interpreting these legal relationships and of resolving possible statutory conflicts. These are functions primarily of a judicial character that, in the Board's opinion, should remain within the purview of the courts wherever possible. They are far removed from the Board's primary responsibility for formulation of monetary policy.

Another special feature of S.1406 is the removal of state controls on periodic fees associated with credit card or debit card accounts as well as transaction charges for credit cards or payment mechanism services. As in the case of interest rate ceilings, the Board favors the determination of such fees and charges by market forces. The prohibition in some states of account or transaction fees on credit card accounts has allowed customers who pay in full by the

end of the billing cycle to use credit services without paying for them. Permitting transaction and access fees in such instances makes economic sense because these charges enable creditors to allocate costs in accordance with the usage of specific services. However, the Board believes that--where necessary--corrective action at the state level would be the most desirable way to address any counter-productive effects of limitations on these fees and charges.

To summarize, the Board supports attempts to remove ceilings that can constrain the price of business, agricultural, and consumer credit. It also supports efforts to eliminate controls on fees that may be charged in connection with consumer credit accounts and payment services. The Board continues to feel, however, that state action rather than federal law should prevail whenever possible in governing pricing policies of these kinds. In view of the large and rapid recent changes in the underlying determinants of the cost and the availability of credit, appropriate action at the state level has become all the more imperative.

Senator LUGAR. Thank you, Governor Teeters.
Dr. Black?

STATEMENT OF HAROLD A. BLACK, BOARD MEMBER, NATIONAL CREDIT UNION ADMINISTRATION,

Dr. BLACK. Thank you, sir.

I am pleased to be here today in order to testify on behalf of the National Credit Union Administration about two pieces of proposed legislation that will have a pervasive effect on the credit union industry if they are enacted.

I strongly endorse the fundamental principles underlying both pieces of legislation. It has become increasingly evident that binding usury ceilings greatly distort the flow of credit throughout the entire economy. Whenever the cost of funds to lenders approaches or exceeds artificial loan rate ceilings, lending activity must be curtailed. Invariably, consumers and small businesses are the first to be affected by the diminished availability of credit.

The misallocation of funds within the financial system induced by interest rate ceilings precludes the optimal utilization of scarce economic resources. Usury ceilings impede the flow of funds to productive activities. Every sector of the economy will benefit greatly from the increased supply of credit that will follow the elimination of usury ceilings on consumer, business, and agricultural credit which is contained in S. 1406.

While S. 963 is commendable because it provides for preemption of State usury ceilings, the proposed bill still fails to solve the basic problem. Establishing an indexed Federal usury rate does not eliminate the possibility that a Federal ceiling could become binding some time in the future just as many State usury ceilings are presently binding.

Beyond the deficiencies of an indexed usury ceiling, the index proposed in S. 963 is not an accurate measure of the cost of funds to lenders. As Governor Teeters has just pointed out, the discount rate is not determined by the forces of supply and demand within the money markets; rather, it is administered by the Board of Governors and reflects the policy goals of the Federal Reserve system.

While S. 963 represents a movement in the right direction, I would prefer to support the adoption of S. 1406. The Credit Deregulation and Availability Act of 1981 offers a permanent solution to the problems precipitated by usury ceilings. The complete elimination of interest rate ceilings on consumers, business, and agricultural credit properly assigns the determination of interest rates on all types of lending to the financial markets and obviates the need to revise the law whenever unanticipated interest rate developments occur.

REPEAL OF THE USURY CEILING

S. 1406 is especially important because it provides an explicit repeal of the usury ceiling contained in the Federal Credit Union Act. I, as a member of the National Credit Union Administration Board, support the removal of the interest rate ceiling on loans issued by Federal credit unions. I strongly believe that loan rates should be a business decision set by individual credit unions. The

basic cooperative nature of credit unions and the forces of competition within the market for consumer credit will insure that the interest rates charged on member loans will remain fair and reasonable.

The following upward shift of interest rates which began in late 1978 and early 1979, the statutory usury ceiling has often severely disrupted Federal credit union operations. Over the past 2 years, intermittent binding usury ceilings have forced credit unions to curtail lending activity. The decline in lending activity has substantially reduced industry growth. The high cost of funds and the artificially low return on loans significantly reduced credit union earnings. Diminished earnings has threatened the long-term viability of many credit unions. The disruption of lending activities has also reduced the credit union share of the consumer credit market.

The binding usury ceiling also increased the number of designated problem credit unions. During 1979, the number of problem credit unions increased fivefold to 817. Those 817 credit unions have total assets of $1.375 billion. The authorization of a less restrictive usury ceiling prevented further deterioration in 1980. At the end of 1980, there were 818 problem credit unions with $1.545 billion in assets.

The abrupt decline in credit union lending activities reduced the presence of credit unions in the consumer credit market. Throughout the 1970's, the credit union share of the consumer credit market had grown steadily. However, during 1979 and 1980, the market share of credit unions began to decline. Since the end of 1978, the share of total outstanding consumer installment credit held by credit unions has fallen from 16.7 percent to 14 percent.

The perverse effects of the usury ceiling are clearly revealed in the growing importance of finance companies as consumer installment lenders. The credit union usury ceiling was originally intended to preserve a low cost source of funds for individual savers. Instead, as credit unions curtailed lending, credit union members were forced to borrow from the more expensive consumer finance companies. Since the end of 1978, the share of total outstanding consumer installment credit held by finance companies has increased from 19.7 percent to 24.5 percent. While credit union loans have remained relatively inexpensive, they have also become less available.

[Complete statement follows:]

TESTIMONY OF

HAROLD A. BLACK, BOARD MEMBER

NATIONAL CREDIT UNION ADMINISTRATION

Mr. Chairman and members of the Subcommittee, I am pleased to be here today in order to testify on behalf of the National Credit Union Administration about two pieces of proposed legislation that will have pervasive effects on the credit union industry if they are enacted. S.1406 which is entitled the "Credit Deregulation an Availability Act of 1981" contains a provision to remove the 15 percent interest rate ceiling on loans made by Federal credit unions. S.963 would authorize all lenders, including credit unions, to charge as much as one percentage point above the Federal Reserve discount rate until April 1, 1983.

I strongly endorse the fundamental principles underlying both pieces of legislation. It has become increasingly evident that binding usury ceilings greatly distort the flow of credit throughout the entire economy. Whenever the cost of funds to lenders approaches or exceeds artificial loan rate ceilings, lending activity must be curtailed. Invariably, consumers and small businesses are the first to be affected by the diminished availability of credit.

The misallocation of funds within the financial system induced by interest rate ceilings precludes the optimal utilization of scarce economic resources. Usury ceilings impede the flow of funds to productive activities. Every sector of the economy will benefit greatly from the increased supply of credit that will follow the elimination of usury ceilings on consumer, business and agricultural credit which is contained in S.1406.

While S.963 is commendable because it provides for pre-emption of state usury ceilings, the proposed bill still fails to solve the basic problem. Establishing an indexed Federal usury rate does not eliminate the possibility that a Federal ceiling could become binding sometime in the future just as many state usury ceilings are presently binding.

Beyond the deficiencies of an indexed usury ceiling, the index proposed in S.963 is not an accurate measure of the cost of funds to lenders. The discount rate is not determined by the forces of supply and demand within the money markets. Rather, it is administered by the Board of Governors and reflects the policy goals of the Federal Reserve System. The discount rate is usually lower than comparable short term competitive rates and adjustments in the rate are made only with a considerable lag.

While S.963 represents a movement in the right direction, I would prefer to support the adoption of S.1406. The "Credit Deregulation and Availability Act of 1981" offers a permanent solution to the problems precipitated by usury ceilings. The complete elimination of interest rate ceilings on consumer, business and agricultural credit properly assigns the determination of interest rates on all types of lending to the financial markets and obviates the need to revise the law whenever unanticipated interest rate developments occur.

S.1406 is especially important because it provides an explicit repeal of the usury ceiling contained in the Federal Credit Union Act. I, as a member of the National Credit Union Administration Board, support the removal of the interest rate ceiling on loans issued by Federal credit unions. I strongly believe that loan rates should be a business decision set by individual credit unions. The basic cooperative nature of credit unions and the forces of competition within the market for consumer credit will ensure that the interest rates charged on member loans will remain fair and reasonable.

CREDIT UNIONS AND THE USURY CEILING

During recent years, the financial system has undergone some fundamental structural changes which have rendered usury rates ceilings obsolete. Accelerating inflation and heightened econmic uncertainty have induced high and volatile interest rates. At the same time, the process of deregulation has increased the competition for deposits. Credit unions and depository institutions can no longer rely upon a stable core of low-cost deposits for a supply of loanable funds. The introduction of the money market certificate induced a substantial increase in the cost of funds to depository institutions. The marginal cost of deposit funds is now tied directly to the weekly auction rate for six month Treasury bills.

Following the upward shift of interest rates which began in late 1978 and early 1979, the statutory usury ceiling has often severely disrupted Federal credit union operations. Over the past two years, intermittent binding usury ceilings have forced credit unions to curtail lending activity. The decline in lending activity has substantially reduced industry growth. The high cost of funds and the artificially low return on loans significantly reduced credit union earnings. Diminished earnings has threatened the long term viability of many credit unions. The disruption of lending activities has also reduced the credit union share of the consumer credit market.

The impact of the usury ceiling has been most evident on credit union lending operations over the past two years. Prior to 1979, the 12 percent usury ceiling for Federal credit unions was not binding. During the sustained economic expansion that followed the 1974 - 1975 recession, lending by Federal credit unions increased rapidly. Total loans outstanding increased at an average annual rate of 23.0 percent between 1976 and 1978. When the usury ceiling became binding in 1979, loan growth fell sharply; from 22.3 percent in 1978 to only 3.1 percent 1979. A study conducted by the NCUA staff estimated that the 12 percent usury ceiling alone reduced credit union lending by $870 million when the ceiling became binding in 1979 and 1980. During 1980, Federal credit unions actually reduced outstanding loans by 7.7 percent.

As lending activity has declined, the growth of credit union assets has slowed markedly. Federal credit union asset growth fell from 17.6 percent in 1978 to 4.9 percent in 1979. For the first time in many years, state chartered credit unions, which are not subject to the Federal usury ceiling, grew faster than Federal credit unions. When the usury ceiling was raised to 15 percent following the passage of the Depository Institutions Deregulation and Monetary Control Act in March 1980, the usury ceiling became less restrictive. Throughout the rest of 1980, Federal credit unions grew more rapidly than state credit unions.

Though credit unions reduced lending activities when the usury ceiling became binding, credit union earnings fell sharply, especially in 1979. Two developments reveal the severe earnings problems encountered by credit unions when the return on loans was not sufficient to cover the cost of funds. In 1979, the National Credit Union Administration waived the statutorily required transfer to reserves so that credit unions could pay competitive dividends on savings. Credit union earnings improved slightly in 1980 when the usury ceiling was raised to 15 percent. While the waiver of the required transfer to reserves was approved for all credit unions during the first quarter of 1980, the waiver was granted only on a case-by-case for the second, third and fourth quarters of 1980.

The binding usury ceiling also increased the number of designated problem credit unions. During 1979, the number of problem credit unions increased fivefold to 817. Those 817 credit unions have total assets of $1.375 billion. The authorization of a less restrictive usury ceiling prevented further deterioration in 1980. At the end of 1980, there were 808 problem credit unions with $1.545 billion in assets.

The abrupt decline in credit union lending activities reduced the presence of credit unions in the consumer credit market. Throughout the 1970s, the credit union share of the consumer credit market had grown steadily. However, during 1979 and 1980, the market share of credit unions began to decline. Since the end of 1978, the share of total outstanding consumer installment credit held by credit unions has fallen from 16.7 percent to 14.0 percent.

The perverse effects of the usury ceiling are clearly revealed in the growing importance of finance companies as consumer installment lenders. The credit union usury ceiling was originally intended to preserve a low cost source of funds for individual savers. Instead, as credit unions curtailed lending, credit union members were forced to borrow from the more expensive consumer finance companies. Since the end of 1978, the share of total outstanding consumer installment credit held by finance companies has increased from 19.7 percent to 24.5 percent. While credit union loans have remained relatively inexpensive, they have also become less available.

CONCLUSION

Usury ceilings have outlived their usefulness. Usury ceilings were appropriate in an era when there was a very limited aggregate supply of consumer credit and interest rates were stable. When the usury ceiling for Federal credit unions was originally established in 1934, the greatest problem confronted by individual borrowers was the small number of lenders and the consequent lack of available credit. Interest rate ceilings were necessary in order to prevent lenders from exploiting their substantial market power and charging excessive interest rates on individual loans.

At the present time, individuals face a very different set of borrowing problems. In recent years, the aggregate supply of consumer credit has grown rapidly. The market for individual loans has become highly competitive. With thousands of institutions engaged in consumer installment lending, the forces of competition preclude the imposition of excessive interest rates on creditworthy borrowers. Individuals now have many alternative sources of credit. The availability of credit only becomes a problem when usury rates are binding. Loan rate ceilings that are below the market-clearing interest rate cause lenders to deny credit to borrowers who are willing to pay competitive rates. Binding usury ceilings interfere with the workings of the market pricing mechanism. When lenders are forced to curtail lending activity, they must resort to nonrate rationing, which is inherently discriminatory. Individual borrowers very often find themselves unable to obtain credit for reasons that have very little to do with the interest rates they are willing to pay on loans.

In closing, I would point out that times have indeed changed. Consumers are far more sophisticated than in the past. The Truth in Lending Act has provided a measure of disclosure, competition is heightened, and I have great faith that credit unions will continue their traditional role of member education and of providing credit at reasonable rates to persons of modest means.

Once again, I would like to urge very strongly the passage of S.1406, the "Credit Deregulation and Availability Act of 1981" as soon as possible. Mr. Chairman, I would be happy to answer any questions that you or the members of the Subcommittee might have.

Senator LUGAR. You continue to have reservations about endorsing preemption by the Federal Government of State usury laws, Governor Teeters, and of course this is a critical point in the legislation because, essentially, it has been argued by both proponents of the bill and people who have testified that this degree of preemption has occurred in other areas of credit—mortgage rates, for example.

Governor TEETERS. It really has not meant much preemption because it is tied to the discount rate, which is currently 14 percent; it is 1 percent above the discount rate, and that has not really freed up most consumer loan rates very much. That was put in, I think, primarily to give other financial institutions the same privilege that the national banks had.

Senator LUGAR. I thought the mortgage rate was really totally unleashed.

Governor TEETERS. No.

Senator LUGAR. Not so?

Governor TEETERS. No.

Senator LUGAR. Let's back up for a second. The whole point of the Deregulation Act of the year before was to bring about a national credit change that offers really substantial preemption, does it not? In other words, we have, aside from this area of consumer credit that we are left with here, a situation by and large in which the rest of the credit situation is federalized in one form or another.

Governor TEETERS. The deregulation part of the Monetary Control Act provides for the phaseout of the Reg Q ceilings over a period of 6 years. So there is still a period in which there will be at least some form of ceiling on the deposit side. And the DIDC has moved to set that schedule now.

USURY LAWS SHOULD BE STATE-REMOVED

But most of these laws are State laws, and they are rather extensive. I remember a year ago looking at the State of Massachusetts, and there are about 14 or more laws regarding usury in one State alone. Since these are State-passed laws, the position of the board is that they should be State-removed laws, whereas the Q ceilings were federally imposed.

Senator LUGAR. Fair enough. But on one side, as many have argued, you have the Federal Government very heavily involved, and on the other, conveniently enough, one can argue that because the States have 14 laws apiece and so forth, they ought to be removing them one at a time. At least those who are involved in this business say, "What is sauce for the goose ought to be sauce for the gander." We have a real problem working it through in this way.

This is why, although many on this committee are strongly in favor of the application of States rights, we have a feeling that the barn door was opened a long time ago. At this stage, we are attempting to get back to a situation where the money coming in, the money going out, has much the same sort of situation.

Governor TEETERS. May I point out that if the Congress does go for Federal preemption, we strongly support the provisions that

would permit the States to reimpose their own usury laws, as I gather some have under the Monetary Control Act.

Senator LUGAR. What would be the effect of that? Let's say that we have a preemption—1406 suggests that—and the 3-year period of time in which States might come back. Some witnesses have argued that indeed States would; some have said that this might become a political issue in States with people falling over themselves competitively to get back into the usury situation. Do you have any feel for that?

Governor TEETERS. I have no feel for what the State reaction would be to that at all.

Senator LUGAR. You would say philosophically, if the preemption occurs, that then the 3-year thing is important?

Governor TEETERS. It is important.

Senator LUGAR. For a tradeoff, for a check and a balance.

Governor TEETERS. Yes. I feel more strongly about the discount rate. It really is the wrong rate to attach any sort of usury ceiling to. It is an administered rate and is set for totally different reasons. I think that it is the wrong rate to use in setting any sort of ceiling.

Senator LUGAR. If you were to rate the relative strength of your comments——

Governor TEETERS. That has my first priority.

Senator LUGAR. Very good.

Dr. Black, what is your feeling about States rights and Federal preemption in this area? You seem to be less troubled in your testimony about this. How do you come out on that question?

Dr. BLACK. Yes, sir. I am not very troubled over that. I do believe very strongly in States rights, but I believe in areas such as this, one that is fraught with emotion and one that is obviously very difficult for the States to address for political reasons, I see no reason why the Congress should not have a preemption and then allow the States to have an override.

My feeling is that money flows now go beyond State lines. If money flows did not go across State borders—if that happened, then I would believe that the States were perfectly correct in enacting this particular sort of legislation, but now I believe that times have indeed changed.

Senator LUGAR. Indeed, both of you are scholars of credit and money. And a great deal of testimony in our two sessions—our first two sessions—addressed itself to that point, that money flows all over the world. Interest rates seem to be affected by international developments as well as national ones, particularly credit markets in our own country with regard to automobiles, for example, or other credit items of a consumer nature seem to dictate a flow in interstate commerce that has been recognized.

So that I suppose in terms of the credit union, we come to the special point that at least a few times in recent years, many credit unions have come to this committee and said, "We are about to close our doors due to the fact that you have imposed such stringent limitations on our loans and what we can do that we have to have relief." So there seems to be a peculiar need with regard to the credit union movement to get free of the shackles.

Dr. BLACK. Yes, sir; that is indeed correct.

Senator LUGAR. And to deal, as I think we heard from officers of credit unions in our last session, from loan committees that are the product of democratic elections of persons who are members of the credit union and have their own check and balance, apparently, on that situation.

I have no questions of either one of you, unless either of you have comments. Clearly, we are indebted to you for coming to make our record more complete. And there were many members of the committee who wanted official testimony from the two of you in your capacities and from other witnesses that we shall have this morning.

Governor TEETERS. May I correct a previous statement. The Monetary Control Act did preempt State ceilings on most home mortgages. That act also provided a limited preemption of State ceilings on business and agricultural loans which may be offered at 5 percent above the discount rate.

Senator LUGAR. Thank you.

That is on business and agriculture, but on mortgages there is total preemption.

Governor TEETERS. Yes.

Senator LUGAR. Thank you very much for coming.

I would like to indicate that the minority has given me a note that questions hopefully might be submitted to you by Senators who are not present today. And if you would help us by responding to those, we would appreciate it.

Governor TEETERS. Certainly.

Dr. BLACK. Certainly.

Senator LUGAR. Our next witnesses will be a panel, Charlotte Chamberlain, Director, Office of Policy and Economic Research of the Federal Home Loan Bank Board; Stanley C. Silverberg, Director, Division of Research, Federal Deposit Insurance Corporation; and Jo Ann Barefoot, Deputy Comptroller for Customer and Community Programs, Office of the Comptroller of the Currency.

STATEMENTS OF CHARLOTTE CHAMBERLAIN, DIRECTOR, OFFICE OF POLICY AND ECONOMIC RESEARCH, FEDERAL HOME LOAN BANK BOARD; STANLEY C. SILVERBERG, DIRECTOR, DIVISION OF RESEARCH, FEDERAL DEPOSIT INSURANCE CORPORATION; AND JO ANN BAREFOOT, DEPUTY COMPTROLLER FOR CUSTOMER AND COMMUNITY PROGRAMS, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Senator LUGAR. I will ask for you to testify in the order that I introduced you, Ms. Chamberlain first of all, and then Mr. Silverberg, and then Ms. Barefoot.

Ms. Chamberlain.

Ms. CHAMBERLAIN. Mr. Chairman, I appreciate this opportunity to express the views of the Federal Home Loan Bank Board on S. 1406 and S. 963, bills which would provide Federal preemption of existing State usury limitations. The Bank Board strongly supports the Federal preemption of State usury ceilings, because we believe that such action is a necessary and integral part of deregulating depository institutions. The Depository Institutions Deregulation and Monetary Control Act of 1980 mandates the elimination of Federal controls on interest rates paid by depository institutions.

The Bank Board supports this goal, because we believe it will lead to a wider range of improved financial services.

The Bank Board believes that the case for deregulation of financial institutions on the asset side of the ledger is just as compelling. We view usury ceilings as being ultimately detrimental to consumers because such restrictions reduce incentives for the supply of financial services, while providing little real protection to the consumer.

The Bank Board believes that usury ceilings lead to a misallocation of resources in the national economy. In addition, we think such artificial constraints prevent S. & L.'s from becoming more diversified financial institutions with a greater emphasis on consumer lending. I would like to address each of these areas in turn, although the major emphasis of my remarks will relate to the role of the institutions regulated by the Bank Board.

CREATE BARRIERS

Overall perspective: The Bank Board believes that State usury ceilings on consumer credit interest rates are undesirable because such limitations create artificial interest barriers to the availability of consumer credit.

When institutions find that their costs of funds exceed the permissible loan rate that they may charge, they are likely to shift from consumer lending to other types of lending that are not subject to such ceilings. The resulting lack of consumer credit availability often precludes small, but creditworthy, borrowers from obtaining funds.

The historical rationale for usury laws—to protect borrowers from unscrupulous lenders—is neither appropriate in today's markets nor is it achievable through usury ceilings.

Increased consumer sophistication, greater competition among financial institutions in the consumer loan market, and increased legislative safeguards such as the Truth-in-Lending Act are providing sufficient protection to consumers against unfairly high loan rates.

In contrast, neither fixed usury ceilings nor usury ceilings indexed to series such as the Federal Reserve discount rate are capable of both protecting consumers and allowing enough yield flexibility to provide sufficient returns to lenders.

When usury ceilings are well above prevailing loan rates, they provide protection to consumers only in a few isolated extreme situations. When usury ceilings are at or below prevailing rates, they inhibit consumer lending because no fixed or indexed usury ceiling can reflect all the variables affecting fair loan rates. Examples of the variables are the incidence of bankruptcy, loan delinquencies, processing costs, the cost of funds, and yields on alternative instruments.

While not providing any significant benefits to consumers, the presence of usury ceilings may depress economic activity. When usury ceilings are binding, business firms may restrict the availability of credit or relocate in other States to take advantage of more favorable lending conditions. A number of studies have shown a significant decline in employment and income in States where usury ceilings are binding.

IMPACT ON S. & L.'S

I would now like to address the effect of these ceilings specifically on S. & L.'s. The Depository Institutions Deregulation and Monetary Control Act of 1980 mandates the elimination of controls on deposit yields. From a philosophical perspective, the Bank Board believes that if S. & L.'s must compete freely for consumer deposits with no regulatory protections or preferences, it is only equitable for those institutions to be able to compete freely on the asset side as well, by making a wider variety of loans at competitive market rates.

In a more practical light, we do not think that S. & L.'s can remain viable without such symmetry. The current financial plight of S. & L.'s is the result of rapid deregulation on the liability side, with limited structural change on the asset side.

While S. & L.'s have not been major consumer lenders in the past, we both expect and support substantial expansion of S. & L.'s consumer lending when economic and financial conditions are favorable. There are several reasons for this change:

First, S. & L.'s have historically maintained their status as specialized mortgage lenders because the 25 basis point rate differential granted to thrifts allowed them to attract funds in sufficient quantity. That rate differential was essential to place S. & L.'s on an equal competitive footing with commercial banks which offered a much wider range of financial services to consumers.

The deregulation of deposit yields means the eventual elimination of the rate differential—it has been eliminated substantially already—and thus S. & L.'s will have to begin offering a broader range of financial services to continue to attract customers. Consumer loans are a vital part of this package of financial services.

Second, S. & L.'s are faced with severe profit volatility problems because of the maturity imbalance between their assets and liabilities. The severe operating losses being incurred by S. & L.'s this year are the result of this maturity imbalance. One solution to this problem is for S. & L.'s to reorient their asset structures to a limited extent away from 30-year mortgage loans to 1- to 3-year consumer loans. This shorter maturity will provide more asset yield flexibiity to S. & L.'s and thus reduce profit volatility problems.

The Bank Board believes that expanded consumer loan activity can be much more attractive and beneficial to S. & L.'s if consumer loan rates are free to reflect the forces of supply and demand.

Third, S. & L.'s must be able to earn normal market rates of return on loans to remain viable. There has been a Federal preemption of mortgage usury ceilings, and we see no reason for treating consumer loans differently.

In order to earn market returns on their lending operations, institutions must be able to react to changing supply and demand conditions and to allocate credit to its highest and best use.

S. & L.'s now have the flexibility to move funds between mortgage markets and consumer loan markets. What is essential is for the loan rates in those markets to be freely determined by market forces so that a misallocation of financial resources does not occur.

In sum, the Bank Board strongly supports broad preemption of State usury ceilings on consumer, agricultural, and business credit.

Because we believe S. 1406 provides an excellent, well-drafted vehicle to accomplish this end, we fully endorse that bill.

As an additional matter, I would like to discuss several provisions of S. 963, a bill introduced by Senator Bumpers which also would preempt State usury ceilings on consumer credit transactions.

Specifically, S. 963 provides that State usury ceilings that are not otherwise preempted are preempted to the extent that the interest charged on the loan is not at a rate exceeding 1 percent above the discount rate, including any surcharges, on 90-day commercial paper in effect at the relevant Federal Reserve bank. Preemption under S. 963 would terminate upon the earlier of State reimposition of a usury limit on April 1, 1983.

Although, if enacted, S. 963 would help relieve problems caused by State usury ceilings, we believe the bill is flawed in its adoption of a discount-rate ceiling and in its termination provision.

LET MARKET FORCES WORK

As stated previously, we believe that market forces, not legal restrictions, should determine interest rates, absent significant countervailing policies. By replacing the State usury ceilings with a discount-rate related ceiling, S. 963 substitutes one inadequate index for another.

As Senator Garn has noted, the Federal Reserve Board has expressed strong reservations about using the discount rate for indexing permissible interest rates, given that the discount rate reflects, at least in part, monetary policy considerations and thus it is not a true indicator of prevailing market rates. We agree with the Fed on this point.

Moreover, we see no reason to sunset the preemption as of April 1, 1983. The value of such preemption is substantially diminished to the extent that it is temporary, especially where significant startup costs are involved.

Conclusion: The Bank Board strongly supports S. 1406. The ultimate beneficiaries of this bill will be consumers. It is the Bank Board's belief that usury ceilings do not provide any real protection to the consumer, but instead create distortions in the availability of consumer credit.

Most significantly, the preemption of usury ceilings will induce new lenders—most notably S. & L.'s—to enter the consumer loan market.

Numerous studies have shown that a high level of competition among business firms is the most important factor affecting the quality, cost, and variety of products and services to customers.

If usury ceilings are eliminated, the Bank Board expects that the 4,000 firms in the S. & L. industry will significantly expand their presence in the consumer loan market. This increased competition will inevitably lead to better financial services for consumers.

[Complete statement follows:]

STATEMENT

OF

CHARLOTTE CHAMBERLAIN, DIRECTOR

OFFICE OF POLICY AND ECONOMIC RESEARCH

FEDERAL HOME LOAN BANK BOARD

Mr. Chairman, I appreciate this opportunity to express the views of the Federal Home Loan Bank Board on S.1406 and S.963--bills which would provide Federal preemption of existing state usury limitations. The Bank Board supports the concepts underlying these two bills. We believe the ultimate effect of such legislation would be beneficial to consumers and would improve the viability of thrift institutions.

The Bank Board strongly supports the Federal pre-eption of State usury ceilings because we believe such action is a necessary and integral part of deregulating depository institutions. The Depository Institutions Deregulation and Monetary Control Act of 1980 mandates the elimination of Federal controls on interest rates paid by depository institutions. The Bank Board supports this goal. In our opinion, it would lead to a wider range of improved financial services.

The Bank Board believes that the case for deregulating the asset side of the ledger is just as compelling as deregulating deposits. We view usury ceilings as being ultimately detrimental to consumers because such restrictions reduce incentives for the supply of financial services while providing little real protection to the consumer.

The Bank Board believes that usury ceilings lead to a misallocation of resources in the national economy. In addition we think such artificial constraints prevent S&Ls from becoming more diversified financial institutions with a greater emphasis on consumer lending. I would like to address each of these areas in turn, though the major emphasis of my remarks will relate to the role of the institutions regulated by the Bank Board.

Overall Perspective

The Bank Board believes that state usury ceilings on consumer credit interest rates are undesirable because such limitations create artificial barriers to the availability of consumer credit. When institutions find that their cost of funds exceeds the permissible loan rate that they may charge, they are likely to shift from consumer lending to other types of lending that are not subject to such ceilings. The resulting lack of consumer credit availability often precludes small, but creditworthy, borrowers from obtaining funds.

The historical rationale for usury laws--to protect borrowers from unscrupulous lenders--is neither applicable in today's markets nor is it achievable through usury ceilings. Increased consumer sophistication, greater competition among financial institutions in the consumer loan market, and increased legislative safeguards such as the Truth-in-Lending Act are providing sufficient protection to consumers against unfairly high loan rates.

In contrast, neither fixed usury ceilings nor usury ceilings indexed to series such as the Federal Reserve discount rate are capable of both protecting consumers and allowing enough yield flexibility to provide sufficient returns to lenders. When usury ceilings are well above prevailing loan rates, they provide protection to consumers only in a few isolated extreme situations; when usury ceilings are at or below prevailing rates, they inhibit consumer lending because no fixed or indexed usury ceiling can reflect all the variables affecting "fair" loan

rates such as the incidence of bankruptcy, loan delinquencies, processing costs, and the cost of funds, and yields on alternative instruments.

While not providing any significant benefits to consumers, the presence of usury ceilings may have a depressing effect on the economies of the affected states. When usury ceilings are binding, business firms may restrict the availability of credit or relocate in other states to take advantage of more favorable lending conditions. A number of studies have shown a significant decline in employment and income in such states.

Impact on S&Ls

I would now like to address the effect of these ceiling specifications on S&Ls. The Depository Institutions Deregulation and Monetary Control Act of 1980 mandates the phase-out of controls on deposit yields. From a philosophical perspective, the Bank Board believes that if S&Ls must compete freely for consumer deposits with no regulatory protections or preferences, it is only equitable for those institutions to be able to compete freely on the asset side as well. They should be allowed to make a wider variety of loans and charge competitive market rates. In a more practical light, we do not think that S&Ls can remain viable without such symmetry in regulation. The current financial plight of S&Ls is the result of rapid deregulation on the liability side with limited structural change on the asset side.

While S&Ls have not been major consumer lenders in the past, we both expect and support substantial expansion of S&L consumer lending when economic and financial conditions are favorable. Indeed, expanded

consumer lending by S&Ls is an integral part of the Bank Board's view of what the deregulated S&L of the 1980s will become. There are several reasons for this change.

First, S&Ls have historically maintained their status as a specialized mortgage lender because the 25 basis point rate differential granted to thrifts allowed them to attract funds in sufficient quantity. That rate differential was essential to place S&Ls on an equal competitive footing with commercial banks which offered a much wider range of financial services to consumers. The deregulation of deposit yields means the eventual elimination of the rate differential--it has been eliminated substantially already--and thus S&Ls will have to begin offering a broader range of financial services to continue to attract customers. Consumer loans are a vital part of this package of financial services that consumers desire. S&Ls cannot become full-service financial institutions and thus continue to grow if they do not participate in the consumer loan market. It is important that usury ceilings do not make consumer loan activity economically infeasible.

Secondly, S&Ls are faced with severe profit volatility problems because of the maturity imbalance between their assets and liabilities. The substantial operating losses being incurred by S&Ls this year are the result of this maturity imbalance. One solution to this problem is for S&Ls to re-orient their asset structures to a limited extent away from 30-year mortgage loans to 1-3 year consumer loans. This shorter maturity will provide more asset yield flexibility to S&Ls and thus reduce profit volatility problems.

Based on the historical behavior of consumer loan rates, the contribution of modestly expanded consumer loan portfolios to increased S&L asset yield flexibility is not great. Consumer loan rates have historically not fluctuated much over the economic cycle and thus the yield flexibility of a consumer loan portfolio is only moderately greater than that of a mortgage loan portfolio. While there are a number of causes of this limited rate variability such as the relative importance of processing costs, a major factor inhibiting market movements in consumer loan rates has been the existence of usury ceilings. The Bank Board believes that expanded consumer loan activity can be much more attractive and beneficial to S&Ls if consumer loan rates were free to reflect the forces of supply and demand.

Third, S&Ls must be able to earn normal market rates of return on loans to remain viable. There has been a Federal pre-emption of mortgage usury ceilings, and we see no reason for treating consumer loans differently. In order to earn market returns on their lending operations, institutions must be able to react to changing supply and demand conditions and to allocate credit to its highest and best use. S&Ls now have the flexibility to move funds between mortgage markets and consumer loan markets. What is essential is for the loan rates in those markets to be freely determined by market forces so that a misallocation of financial resources does not occur. Artificially forcing S&Ls to remain in mortgage loan markets would mean sub-normal returns to S&Ls and a sub-normal availability of consumer credit. Pre-empting usury ceilings will preclude this possibility to the advantage of both consumers and lenders.

Provisions of the Proposed Legislation

With this as background, I would like to turn now to S.1406, particularly Title II which would amend Title V of Public Law 96-221 by adding a new subpart, entitled "Consumer Credit."

Looking at Title II, we fully support operative section 531, which provides that state usury ceilings shall not apply to an "extension of consumer credit" made by a "creditor." Moreover, we support the definitions set forth in section 532. We believe that these definitions will provide desirable guidance and certainty to both lenders and borrowers concerning the scope and applicability of the preemption. We are particularly pleased that the definition of "creditor" includes persons who make mortgage credit extensions, and therefore presumably includes all thrift institutions. In addition, we read the sentence that excludes from the definition of creditors persons that have not complied with state licensing requirements as clearly inapplicable to Federally chartered associations in that they are not subject to state licensing requirements. Nevertheless, we would prefer a clear statement in the section-by-section analysis of the bill explaining that the provision applies only to state chartered creditors or lenders that are otherwise subject to state law. This would prevent any confusion as to whether Federal associations must comply with state licensing requirements.

As a final technical point, we note that by excluding loans subject to section 501 of Public Law 96-221 from its definition of consumer loan, the bill arguably creates an anomaly with respect to loans that are secured by a first lien on a residential manufactured home. Under section 501(c) of

Public Law 96-221, state usury ceilings on loans secured by residential manufactured homes are preempted only if such loans comply with consumer protection provisions prescribed by the Bank Board. Because such loans that do not comply with the Bank Board's consumer protection provisions are not "subject to the provisions of section 501" in that they do not invoke preemption, they would fall within the bill's definition of consumer loan and therefore would invoke preemption under the bill's new section 531. In order to avoid this anomaly, we suggest that the bill be amended to preempt usury ceilings on loans secured by residential manufactured homes either only under section 501 or only under new section 531.

We note that the definition of the term "extension of consumer credit" is broadly defined to include credit extended for personal, family, or household purposes. We are pleased that this definition would clearly encompass second mortgage loans, a major form of consumer credit extended by thrift institutions. I believe that you have heard testimony from the Federal Home Loan Mortgage Corporation on its Home Improvement Loan (HIL) program and the important benefits of your proposed legislation to that program in this regard.

Second, we support section 533, as amended. We believe it is reasonable for states to be allowed to reject the Federal preemption and to re-impose rate ceilings, subject to the three-year limitation for such action. We also believe that section 533(b)(2) will prove very useful in defining Congressional intent regarding when the preemption applies to "ongoing" credit relationships. Moreover, we believe that the 18-month phase-out period for open-end credit extensions is highly desirable in

order to provide a creditor with time to adjust its lending activities to satisfy the reimposition of the state usury ceiling.

Third, we note that under new section 534, only the Board of Governors of the Federal Reserve System, as opposed to each Federal financial regulatory agency, would be authorized to publish interpretations regarding the scope and application of the usury preemption. We understand that single-agency authority is deemed appropriate in that interpretative authority is to be limited to significant questions concerning the coverage of the Act, and that substantial regulatory impact due to this authority is not anticipated. In our view, however, single-agency authority appears to be more desirable than multi-agency authority where there may be a need for extensive regulations requiring the exercise of technical expertise. Because this need is not present here, we believe it would be more efficient to follow the normal procedure of allowing each regulatory agency to issue regulations governing consumer loans made by institutions subject to its supervisory authority. For example, we note that agency interpretations under existing Subpart C of Title V of Public Law 96-221 have been consistent and that multiple authority has proven no burden to the private sector or to any one agency.

Concerning Title III, we fully support removing the federal limitation on interest rates that may be charged by federally-chartered credit unions. Such removal is consistent with our belief that usury ceilings frustrate public policy, regardless of whether such ceilings derive from federal law or from state law.

Backtracking to Title I, we support the bill's provisions concerning extension of agricultural and business credit. We endorse extending

preemption to credit extensions involving less than $1,000 and elimination of the March 31, 1983 expiration date of the current federal preemption. In addition, we support elimination of the federal ceiling on the interest that may be charged on agricultural and business loans. We are pleased that the bill defines "agricultural credit" and "business credit," thereby providing helpful guidance as to the applicability of Title I to various transactions.

In sum, we support broad preemption of state usury ceilings on consumer, agricultural, and business credit. Because we believe S.1406 provides an excellent, well-drafted vehicle to accomplish this end, we fully endorse that bill.

As an additional matter, I would like to discuss several provisions of S.963, a bill introduced by Senator Bumpers which also would preempt state usury ceilings on consumer credit transactions. Specifically, S.963 provides that state usury ceilings that are not otherwise preempted are preempted to the extent that the interest charged on the loan is not at a rate exceeding one percent above the discount rate, including any surcharges, on ninety-day commercial paper in effect at the relevant Federal Reserve Bank. Preemption under S.963 would terminate upon the earlier of state reimposition of a usury limit or April 1, 1983.

Although, if enacted, S.963 would help relieve problems caused by state usury ceilings, we believe the bill is flawed in its adoption of a new discount-rate ceiling and in its termination provision. As stated previously, we believe that market forces, not legal restrictions, should determine interest rates, absent significant countervailing policies. By replacing the state usury ceilings with a discount-rate related ceiling,

S.963 substitutes one inadequate index for another. As Senator Garn has noted, the Federal Reserve Board has expressed strong reservations about using the discount rate for indexing permissible interest rates, given that the discount rate reflects at least in part monetary policy consideratons and thus it is not a true indicator of prevailing market rates. We agree with the Fed on this point.

Moreover, we see no reason to sunset the preemption as of April 1, 1983. The value of such preemption is substantially diminished to the extent that it is temporary, especially where significant start-up costs are involved.

Conclusion

The Bank Board strongly supports S.1406. The ultimate beneficiaries of this bill will be consumers. It is the Bank Board's belief that usury ceilings do not provide any real protection to the consumer, but instead create distortions in the availability of consumer credit. Most significantly, the preemption of usury ceilings will induce new lenders--most notably S&Ls--to enter the consumer loan market. Numerous studies have shown that a high level of competition among business firms is the most important factor affecting the quality, cost, and variety of products and services to consumers. If usury ceiling problems are eliminated, the Bank Board expects that the 4,000 firms in the S&L industry will substantially expand their presence in the consumer loan market. This increased competition will inevitably lead to better financial services for consumers.

Senator LUGAR. Mr. Silverberg, would you testify, please.

Mr. SILVERBERG. I appreciate the opportunity to present our views on S. 1406 and S. 963.

I would like to—we have a relatively short statement, but I would like to summarize that if I may.

Senator LUGAR. That would be fine.

Mr. SILVERBERG. The Monetary Control Act of 1980 permanently preempted State usury ceilings on most residential first mortgages, subject to a provision permitting States to reinstate ceilings during a 3-year period ending April 1983.

Subject to a similar reinstatement provision, the act also created a temporary preemption of certain State usury ceilings on business and agricultural loans and substituted a Federal ceiling equal to 5 percent over the Federal Reserve discount rate.

Additionally, the act gave State banks insured by the FDIC the right, already enjoyed by national banks, to charge 1 percent above the Federal Reserve discount rate, or the highest rate permitted by applicable State law, on consumer and other types of loans. This right was also granted to insured savings and loan associations and credit unions.

S. 963 would extend the right to charge 1 percent above the Federal Reserve discount rate to all other lenders on a temporary basis. And it would include any surcharge on the discount rate in determining the permissible ceiling.

S. 1406 is much more far reaching. It would permanently preempt State usury ceilings and related types of limitations on business, agricultural, and consumer credit, without establishing any alternate Federal ceiling or restriction.

Within 3 years after enactment of S. 1406, however, State legislatures would be permitted to reinstate State restrictions in this area.

S. 1406 would also eliminate Federal restrictions on the rate of interest that may be charged by Federal credit unions.

USURY CEILINGS RESTRICT CREDIT FLOW

Credit markets operate most efficiently when money costs are not constrained by usury ceilings or by limitations on what financial institutions can pay to acquire money. Usury ceilings tend to reduce the flow of credit into those areas constrained by ceilings. They particularly limit the availability of credit to higher risk, usually lower income borrowers.

In jurisdictions where market rates have exceeded usury ceilings, sellers of autos, appliances, and other products may subsidize credit costs and recapture the subsidy through product pricing. While this prevents credit from drying up, this process does not promote efficient resource allocation and it reduces competition in these markets.

Consequently, the benefits of artificially low usury ceilings to the consumers are illusory.

In recent years, the market for deposits and other sources of funds for financial institutions have become more competitive. Increasingly, depository institutions have had to pay market rates related to national credit markets for their funds.

Overly restrictive State laws, limiting loan rates, tend to conflict with this deregulatory process and under certain circumstances can make it difficult for depository institutions to operate in an efficient and sound manner.

Nevertheless, Mr. Chairman, the FDIC continues to accept the principle that unless national interest requires some Federal intervention, the Federal Government should not interfere with State regulation of credit terms.

Last year, in the Monetary Control Act, Congress and the President determined that national interest required a significant override of State usury laws with respect to housing and other areas. Since the passage of that act, several States have moved quickly to change their usury laws. These actions have involved either a liberalization of existing statutes or an override of the Federal preemption. A few States have actually acted on both fronts.

Some States still have usury ceilings that are restrictive in relation to the current financial environment. Clearly, there is room for further action on the part of the States to modify their usury laws in accordance with market conditions. But this does not necessarily argue for further Federal preemption.

Many States have demonstrated a willingness to act decisively in modifying or eliminating their usury ceilings.

I would like to comment on some of the features of these two bills.

As I understand it, under S. 963, banks would be affected, because any surcharge on the discount rate would be added in determining the usury ceiling on consumer loans.

The impact of this legislation, if it were enacted today, would be to liberalize usury ceilings in some States. Nevertheless, I have considerable difficulty with tying usury ceilings to the discount rate. At present this is, as was pointed out earlier, an administered rate, which sometimes may be out of line with the market for various policy reasons.

In periods where money has been readily available, the discount rate has been below market loan rates. Presumably at such time, existing ceilings in some States would prevail, and this might work if the ceilings were reasonable.

In any event, the surcharge, from a technical standpoint, should not be part of any rate index. If Congress should choose to liberalize the Federal ceiling, it would be preferable if a fixed amount—say 3 or 4 percent—were added to the discount rate, or preferably to some other index.

Suppose S. 963 were in existence today, the prevailing Federal ceiling would be 19 percent or the State ceiling, whichever is higher. This could actually undercut State action to liberalize existing ceiling, under the illusion that this 19 percent rate might continue to prevail.

Suppose that indications of a slowing economy and declining money market rates persuaded the Federal Reserve to lower the discount rate, say, by 1 percentage point to 13 percent and eliminate the surcharge. The ceiling would fall overnight from 19 percent to 14 percent, a decline that could well be way out of line with the changes in money market conditions.

If usury ceilings are to be indexed, it is preferable that they be indexed to a market rate and certainly not tied to anything subject to temporary administrative change such as a surcharge.

The other bill, S. 1406, would essentially treat other forms of bank lending the same way the 1980 law treats home financing. In this sense, S. 1406 involves a greater degree of uniformity of treatment among all loan categories than does S. 963.

However, S. 1406 represents a significantly more extreme form of Federal preemption than S. 963. We are in an uncertain transition period of deregulation. The impact of the process may differ from State to State. For some States, 3 years may not be a sufficient time to respond to the override provision of S. 1406.

SWEEPING AWAY CONSUMER PROTECTION LAWS

Also, the broad language of S. 1406 could be construed as sweeping away consumer protection laws related to interest.

Mr. Chairman, there is no doubt that usury ceilings have negative economic effects. They are also impediments to the deregulation process that is currently underway. However, when such problems exist, the States generally are capable and willing to act, and many have done so.

Thank you.

[The complete statement follows:]

83-025 O - 81 - 34

STATEMENT OF

STANLEY C. SILVERBERG, DIRECTOR
DIVISION OF RESEARCH
FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Chairman

I appreciate this opportunity to present to your Committee the FDIC's views on S. 1406, the "Credit Deregulation and Availability Act of 1981," introduced by Senators Lugar, Garn, Proxmire and D'Amato, and S. 963, a bill "To authorize loans at interest rates in excess of certain State usury ceilings," introduced by Senators Bumpers and Pryor.

EXISTING LAW

The Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 132) (DIDMCA) permanently preempted State usury ceilings on most first mortgage loans secured by residential real property, subject to a provision permitting States to reinstate such ceilings during the three-year period ending April 1, 1983. Subject to a similar reinstatement provision, the 1980 Act also created a temporary preemption (until April 1, 1983) of certain State usury ceilings on business and agricultural loans of $1,000 or more and substituted a federal ceiling equal to five percent over the Federal Reserve discount rate. Thirdly, the 1980 Act accorded to State banks insured by the FDIC the right already enjoyed by national banks to charge one percent above the Federal Reserve discount rate (or the highest rate permitted to be charged by any lender under applicable State law) on consumer and other types of loans. This right, subject to termination by State legislative enactment at any time after April 1, 1980, was also granted to insured savings and loan associations

and credit unions and to small business investment corporations. The statutory framework already allows States considerable latitude. For example, lenders in Indiana may charge as much as 36 percent for certain small loans.

S. 963

Under the 1980 Act the right generally to charge one percent above the Federal Reserve discount rate is limited to insured depository institutions and SBIC's. S. 963 would extend this right to all lenders on a temporary basis (until April 1983 or such earlier date as may be specified in State legislation overriding S. 963), and it would include any surcharge on the discount rate in determining the permissible ceiling.

S. 1406

S. 1406 is much more far-reaching than S. 963. It would permanently preempt State usury ceilings and related types of limitations on all business, agricultural and consumer credit, without establishing any alternative federal ceiling or restrictions. Within three years after enactment of S. 1406, however, State legislatures would be permitted to reinstate State restrictions in this area. S. 1406 would also eliminate federal restrictions on the rate of interest that may be charged by federal credit unions.

EFFECTS OF CEILINGS

Credit markets operate most efficiently when money costs are not constrained by usury ceilings or by limitations on

what financial institutions can pay to acquire money. Usury ceilings tend to reduce the flow of credit into those areas constrained by ceilings. That is true with respect to the type of loans affected by ceilings and the States where they apply. Usury ceilings particularly may limit the availability of credit to higher-risk (usually low income) borrowers.

In jurisdictions where market rates have exceeded usury ceilings, sellers of autos, appliances or other products may subsidize credit costs and recapture the subsidy through product pricing. While this prevents credit from "drying up", this process does not promote efficient resource allocation. Consequently, the benefits of artificially low usury ceilings to the consumer may be more illusory than real.

In recent years the markets for deposits and other sources of funds for financial institutions have become more competitive. Increasingly, depository institutions have had to pay market rates, related to national credit markets, for their funds. Overly restrictive State laws limiting loan rates tend to conflict with the deregulatory process and, under certain circumstances, can make it difficult for depository institutions to operate in an efficient and sound manner.

STATE ACTION

Nevertheless, the FDIC continues to accept the principle that, unless the national interest requires some federal intervention,

the federal government should not interfere with State regulation of credit terms. The lending practices and portfolio restriction applicable to the banks we examine are determined by State law, and the FDIC is accustomed to dealing with varying State statutes.

Last year, in the Depository Institutions Deregulation and Monetary Control Act of 1980, Congress and the President determined that the national interest required a significant override of State usury laws with respect to housing and other areas. Consumer loan ceilings were affected only where State usury ceilings were less than the discount rate plus one percent. Since the passage of the Act, several States have moved quickly to change their usury laws. These actions have involved either a liberalization of existing statutes or an override of the federal preemptions under the DIDMCA. A few States have acted on both fronts.

Approximately one-third of the States have substantially increased or removed their usury ceilings on non-mortgage loans, the categories primarily under consideration in the bills being discussed in these hearings. Indiana, Texas and New York are good examples. Effective this month, Indiana raised its basic usury ceiling from 18 to 21 percent and, as I pointed out earlier, permits lenders to charge up to 36 percent on unpaid balances under $540. In May, Texas raised its ceiling on all loans of under $250,000 from 10 percent to a ceiling based on either twice the six-month U. S. Treasury bill rate at the time, or an average of previous quarterly rates on these bills. In

rate or some other index. Suppose S. 963 were in existence today. The ceiling would be 19 percent or the State ceiling, whichever is higher. Suppose in a few weeks indications of a slowing in the economy and declining money market rates persuade the Federal Reserve to lower the discount rate to 13 percent and eliminate the surcharge. The ceiling would fall overnight from 19 to 14 percent, a decline that is way out of line with changes in money costs. If usury ceilings are to be indexed, it is preferable that they be indexed to a market rate and certainly not tied to anything subject to temporary administrative requirements, such as a surcharge.

The other bill, S. 1406, would essentially treat other forms of bank lending the same way the 1980 law treats home financing. In this sense, S. 1406 involves a greater degree of uniformity of treatment among all loan categories than does S. 963. However, S. 1406 represents a significantly more extreme form of federal preemption than S. 963. S. 1406 does, however, give States three years to reimpose existing or modified usury ceilings. As I said, ten States have already taken such action since passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. However, we are in an uncertain transition period of deregulation, and the impact of the process may differ from State to State. For some States, three years may not be sufficient time to respond to the override provision of S. 1406.

We also would object to the broad language in S. 1406 which could be construed as sweeping away all consumer protection laws

Senator LUGAR. Thank you very much, sir.

Ms. BAREFOOT. I am pleased to present the views of the Office of the Comptroller of the Currency on proposed S. 963 and S. 1406, bills which would further deregulate existing interest rate ceilings. The first Comptroller of the Currency aptly summarized the artificial interest rate ceilings more than 100 years ago. He took issue with the caprice of State usury laws in his report to Congress in 1863, and concluded with this statement: "Where money is abundant, it is cheap; where scarce, it is dear. And no legislation has been able to control the effect of this general law."

IMPACT OF ARTIFICIAL USURY CEILINGS

The Comptroller's office is seriously concerned with the impact of artificial usury ceilings on the availability and allocation of credit in various markets. As we have stated in the past, usury laws should be repealed, preempted or substantially modified because they create arbitrary distortions in our capital market system.

Further, as the sponsors of S. 963 recognize, when usury laws are preempted with respect to some, but not all creditors, substantial market disequilibriums may occur. Such disruptions affect not only the availability of credit, but also the viability of businesses which must borrow at market rates but lend at substantially lower rates.

We support Federal legislative efforts to ameliorate the problems engendered by usury laws. S. 1406 effectuates the long-range goal of deregulating the cost of credit. We therefore prefer its enactment to the continued piecemeal approach represented by S. 963.

Evidence collected over the years overwhelmingly indicates that the elimination of restrictive usury limits would be in the public interest. Generally usury laws fail to accomplish their desired objective, have an adverse effect on production and employment, and distort the allocation of credit among markets and in States. Rather than protecting small, low-income and marginally qualified borrowers from unscrupulous lenders, usury laws either force these borrowers out of the credit market or require them to go to unregulated creditors or loan sharks.

Studies have also shown that usury ceilings tend to affect employment adversely and to dampen economic growth. Moreover, the geographic distortions in the distribution of credit engendered by usury laws lead to inefficiencies and inequities in the national marketplace. The Arkansas experience need not be recounted here but constitutes dramatic evidence of the inefficiency and dislocation created by arbitrary rate ceilings.

The actions of the 96th Congress with regard to usury preemption represent a step toward a more competitive, less regulated environment. However, further reforms are needed. The current flexible federal usury alternative for business and agricultural loans is only temporary. In addition, the maximum rate authorized by DIDA for consumer loans is too low to allow market forces to operate effectively in the present high rate environment.

Finally, DIDA's preemption of State ceilings on consumer loans is only available to federally insured lenders. It is unavailable to retailers and finance companies, which are currently suffering financial hardships in States with usury rates. It is also inconsistent

with the direction which Congress has moved in phasing out deposit interest rate ceilings. If banks and other financial institutions are to maintain their long-term viability, they must be able to adjust their interest rates and fees in response to changes in their cost of funds and operating expenses. The ability of depository institutions to pay market rates to depositors is necessarily dependent on similar flexibility in their authority to charge such rates on their loans.

Finally, State usury laws are quickly becoming an anachronism in a financial system which is increasingly national in scope. Legal restrictions that attempt to set the terms and conditions for local lending are becoming less and less effective. A national response is necessary, one which would rationalize and equalize the legal framework and allow the marketplace to determine the price of credit.

I have included in my written statement our views regarding the specifics of the two bills now before the subcommittee. We regard S. 963 as a stop-gap measure which would correct an imbalance that exists under the current federal preemption. As such, it is a step in the right direction.

In our opinion, however, S. 1406 offers a better solution to the problems we have described. It is the logical conclusion to the deregulation of interest rate ceilings begun in 1980. We do, however, have reservations with respect to specific provisions of S. 1406. A primary concern is that in the process of preempting State usury ceilings, which as we have stated, do not inure to the long-run benefit of consumers, the legislation appears also to sweep away various consumer protections contained in state usury laws.

RETENTION OF SPECIFIC CONSUMER PROTECTION LAWS

Elimination of consumer credit usury ceilings, as contemplated by S. 1406, should provide clearly for retention of specific State safeguards affecting consumer loan transactions. Although certain provisions for this purpose are contained in S. 1406, the bill's coverage is ambiguous and appears to encompass some State consumer protection laws that do not relate directly to interest charges.

We also believe that serious consideration should be given to transitional problems that might arise as a consequence of an immediate lifting of usury ceilings. Individuals with large, outstanding balances on open-end lines of credit should not be exposed to large, unanticipated increases in their monthly payments caused by sudden increases in their finance charges.

To conclude, the Office of the Comptroller of the Currency supports consideration by the Congress of federal preemption of usury ceilings and we welcome the opportunity to work with the subcommittee to fashion a solution to these problems.

[The complete statement follows:]

STATEMENT OF

JO ANN S. BAREFOOT

DEPUTY COMPTROLLER FOR CUSTOMER AND COMMUNITY PROGRAMS

OFFICE OF THE COMPTROLLER OF THE CURRENCY

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

July 21, 1981

I am pleased to present the views of the Office of the Comptroller of the Currency on proposed S. 963 and S. 1406, bills which would further deregulate existing interest-rate ceilings. S. 963 would expand to all lenders the current federal preemption of state usury ceilings, which permits federally-insured lenders to charge interest at one per cent above the Federal Reserve discount rate on all loans. S. 1406, the proposed Credit Deregulation and Availability Act of 1981, would broadly preempt all state usury ceilings on business, agricultural, and consumer loans and allow the marketplace to determine the rate of interest on these loans.

We are seriously concerned with the impact of arbitrary usury ceilings on the availability and allocation of credit in various markets. As we have stated on several occasions, usury laws

should be repealed, preempted, or substantially modified because they create arbitrary distortions in our capital market system. Further, as the sponsors of S.963 recognize, when usury laws are preempted with respect to some but not all creditors, substantial market disequilibriums may occur. Such disruptions affect not only the availability of credit but also the viability of businesses which must borrow at market rates but lend at substantially lower rates. We support federal legislative efforts to ameliorate the problems engendered by usury laws. S. 1406 effectuates the long-range goal of deregulating the cost of credit; we thus prefer its enactment to the continued· piecemeal approach represented by S. 963.

Goals vs. Effects

Evidence collected over the years overwhelmingly indicates that the elimination of restrictive usury limits would be in the public interest. Generally, usury laws:

-fail to accomplish their desired objectives,
-have an adverse effect on production and employment, and
-distort the allocation of credit among markets and states.

Usury laws are intended to protect small and low-income borrowers from unscrupulous lenders who might otherwise charge excessive interest rates. These goals are important, but usury laws have unintended and adverse effects on borrowers, financial institutions, and the public at large, particularly during periods of inflation and contracted credit availability. When market interest rates are above usury ceilings, many borrowers have been unable to obtain loans from commercial banks or other financial institutions. During such times, credit flows into markets not subject to usury ceilings. This has occurred during every period of high interest rates over the last fifteen years, at the expense of borrowers, lenders, and the efficient operation of the marketplace.

Restrictive interest rate limitations quickly close off conventional credit sources, particularly to high-risk and low-income borrowers. When lenders are unable to charge rates sufficient to yield a reasonable rate of return, they generally stop or substantially curtail lending to such marginal borrowers. Should a lender's cost of funds exceed the prevailing usury ceilings, all consumer lending may be expected to cease.

Borrowers must forego obtaining credit, go to loan sharks for loans made above usury rate limits, or seek nonmarket sources of credit such as family or friends. Alternatively, borrowers may resort to out-of-state sources for necessary credit. These conclusions have been documented in several studies of consumer finance companies, commercial banks, and mutual savings banks. Similar studies of new automobile, mortgage, and personal loan markets offer the same conclusions. The results are consistent -- low-income consumers are denied access to conventional credit when market rates exceed usury ceilings.

Furthermore, firms which must operate in markets subject to usury restrictions feel the impact on both costs and revenues. In the consumer finance industry, in which rate restrictions abound, low rate ceilings tend to result in fewer and larger loans because credit is allocated to low-risk consumers and larger loans are less costly to make. When low usury ceilings are combined with low legal loan size limits, the number of loans increases, but low-income, high-risk customers still find it difficult, if not impossible, to obtain credit. Instead, low-risk customers continue to receive most of the loans, but are forced to "double-up" by acquiring costly multiple loans to get the amount of credit they desire.

These adverse effects of usury ceilings on individual borrowers and lenders are translated on a broader scale into harm to the economies of states which have low interest rate ceilings, and, in turn, to the nation's economy.

Credit is an essential ingredient to commerce, and usury ceilings and other arbitrary restrictions that limit credit availability tend to affect employment adversely and dampen economic growth. For example, a 1977 study showed that in Tennessee, which until 1978 had a constitutional interest cap of 10 percent, the economy grew faster than the national economy except when market interest rates rose above the state usury ceilings. Between 1974 and 1976, when market rates exceeded the usury ceilings, the study found that Tennessee's annual loss in production averaged $50 million; the annual loss of jobs averaged 7,000; the annual loss of retail sales averaged $80 million; and the annual loss of assets in financial intermediaries averaged $1.25 billion.

Such geographic distortions in the distribution of credit lead to significant inefficiencies and inequities in the national marketplace. This is apparent from differences in business activity among various states. Arkansas, which has a ten percent constitutional usury limit, is a notable example. A 1976 study of Texarkana noted distinct differences between the types of firms located on the Texas side of the city and those located on

the Arkansas side. Considerably less retail trade was conducted on the Arkansas side, despite the approximately equal distribution of Texarkana's population between the states. The majority of automobile dealers, appliance stores, and other businesses that rely on consumer credit had moved to the Texas side of the city. The Subcommittee has heard a great deal about the problems Arkansas has experienced over the past year due to its constitutional rate ceiling. Clearly, inefficiency and inconvenience result from such locational patterns.

The inescapable conclusion was well stated over one hundred years ago by the first Comptroller of the Currency, Hugh McCulloch. Mr. McCulloch took issue with the caprice of state usury laws in his initial report to Congress in 1863 and concluded: "Where money is abundant it is cheap, where scarce it is dear; and no legislation has been able to control the effect of this general law."

<u>Timeliness for Change</u>

Actions of the 96th Congress reflect Congressional recognition of the problems associated with usury ceilings. Title V of the Depository Institution Deregulation and Monetary Control Act of 1980 (DIDA) and its subsequent amendment in the Housing Act of

1980, preempted all usury ceilings on first lien mortgages, set an alternative federal usury ceiling of five percent above the Federal Reserve discount rate for business and agricultural loans of $1,000 or more, and, for all other loans, established an alternative ceiling of one percent above the Federal Reserve discount rate for all federally-insured lenders. States may override the first two of these federal preemptions prior to April 1, 1983.

While these provisions of DIDA represent a step toward a more competitive, less regulated environment, further reforms are needed. The flexible federal usury alternative for business and agricultural loans is only temporary. In addition, the maximum rate autnorized by DIDA for consumer loans is too low to allow market forces to operate effectively in determining interest rates in the present high-rate environment. The current Federal Reserve discount rate is 14 percent. With the prime rate of most banks hovering around 20 percent, it is unrealistic to expect lenders to charge a maximum of 15 percent on consumer loans. Finally, as has been stated so often at these hearings, DIDA's preemption of state ceilings on consumer loans is only available to.federally-insured lenders. It is unavailable to retailers and finance companies, which are currently suffering severe financial hardships in states with restrictive rate ceilings on consumer loans.

Retention of usury ceilings is also inconsistent with the direction in which Congress has moved in phasing out deposit interest-rate ceilings. With the eventual elimination of all deposit rate limitations, changes in the average cost of funds to depository institutions will reflect more closely changes in market rates of interest. If banks and other financial institutions are to maintain their long-term viability, they must be able to adjust their interest charges and fees in response to changes in their cost of funds and operating expenses. The ability of depository institutions to pay market rates to depositors is necessarily dependent upon similar flexibility in their authority to charge such rates on their loans. When ceilings on consumer loans are set at unrealistically low levels, depository institutions will be unable to engage profitably in consumer lending, if faced with increasingly high and volatile costs for their funds.

Finally, state usury ceilings are quickly becoming an anachronism in a financial system which is increasingly national in scope. Legal restrictions that attempt to set the terms and conditions for local lending are becoming less and less effective. Households in Maryland may use bank credit cards issued by a California bank and, therefore, be subject to the less restrictive

California usury ceilings. Similarly, lenders in a state subject to low usury limits may increase their purchases of out-of-state loans or may sell their loanable funds in unregulated national markets such as the interbank federal funds market. Thus some individuals and institutions are able to circumvent or adapt to usury ceilings, while others suffer from their impact. These inequities call for a national response which would rationalize and equalize the legal framework and allow the marketplace to determine the price of credit. With interstate barriers to the provision of credit becoming more insignificant each day, interest-rate ceilings are properly a subject of federal concern now, just as railway rates were at the turn of the century.

Recommendations

S. 963 is intended to treat all lenders equitably, whether or not federally insured, by allowing an alternative federal rate ceiling of one percent above the Federal Reserve discount rate for all types of credit, including consumer loans. We view this bill as a stop-gap measure which would correct an imbalance created, in part, by the partial preemption enacted in Sections 521-529 of DIDA. While we regard the proposal as a step in the right direction, we have some reservations regarding its provisions.

First, under Sections 521-529 of DIDA, federally-insured lenders are authorized to charge one percent above the discount rate. This ceiling does not expressly include any surcharge that the Federal Reserve Banks may impose upon the basic discount rate. S. 963, however, would include, in the ceiling for non-federally-insured lenders, the surcharge, which currently is four percent. Enactment of the bill would, therefore, put federally-insured lenders at a competitive disadvantage with respect to other lenders, a situation which the bill's authors presumably do not intend to create. We suggest that, should the bill be enacted, it be modified to amend Sections 521-525 of DIDA to include the surcharge.

Further, if a federal rate ceiling is to be retained, we suggest that the Federal Reserve discount rate is not an appropriate index. Use of the discount rate imposes an essentially short-term index on markets that often involve long-term lending transactions. The discount rate is a tool of monetary policy and may not be directly related to the market cost of lender funds. Should Congress decide to create an alternative federal ceiling, we believe that several indices would be preferable to a single rate. For example, indexing the federal interest rate ceilings to changes in the rates on Treasury notes or bills of average maturity comparable to particular categories of loans might be preferable to the continued use of the discount rate.

In our opinion, S.1406 represents a better solution to the problems described above. It represents the logical conclusion to the deregulation of interest-rate ceilings begun in DIDA. We do, however, have reservations with respect to specific provisions of the bill.

Our primary concern is that in the process of preempting state usury ceilings, which, as we have stated, do not inure to the long-run benefit of consumers, the legislation appears also to sweep away various consumer protections. Total elimination of state usury ceilings could easily expose unwary borrowers to unscrupulous lenders and lending practices. The Subcommittee has already heard evidence of such practices in states which have enacted broad credit deregulation laws. In those parts of the country where credit markets are not yet reasonably competitive, a need remains for minimum safeguards to protect the rights of those most vulnerable to predatory lending practices. We believe, therefore, that the elimination of consumer usury ceilings, such as contemplated by S. 1406, should contain provisions for retention of specific state safeguards affecting consumer loan transactions. Although certain provisions for this purpose are contained in S. 1406, greater specificity should be provided as to the states' role and the type of protections which may be retained or enacted by each state with regard to consumer lending.

For example, some states have enacted small loan acts, retail installment credit sales laws, automobile sales finance acts, and other credit codes, such as the Uniform Commercial Credit Code, to provide such safeguards. These laws often limit or prohibit prepayment penalties, late fees, attorney's fees, the use of the Rule of 78's, and acquisition fees, as well as certain contractual provisions with regard to consumer credit. We believe that the federal law should provide specifically for either the preemption or continued viability of such protections.

We also believe that serious consideration should be given to transitional problems that might arise as a consequence of an immediate lifting of usury ceilings. For example, individuals with large outstanding balances on open-end lines of credit should not be exposed to large unanticipated increases in their monthly payments caused by sudden increases in their finance charges. One response to this problem would be to require that the former interest rate be retained on the present outstanding balance.

Conclusion

The Office of the Comptroller of the Currency supports consideration by the Congress of federal preemption of usury

ceilings. In the current environment of inflation and high interest rates, fixed-rate usury laws are counterproductive. As we have testified before, they tend either to restrict the availability of credit or encourage abuses by unregulated lenders. Recent legislation which provides for the phasing out of interest-rate ceilings on deposits represents an important step toward creating a competitive marketplace. Meaningful reform of usury laws, combined with protection of consumers against anticompetitive practices, fits logically into this legislative pattern.

We would welcome the opportunity to work with the Congress to fashion a solution to these problems.

Senator LUGAR. Thank you. Each of you, in your testimony, opposed indexing rate ceilings to the federal discount rate. It appears that you may also have reservations about any form of indexing. I will try to pin that question down, because it certainly is central to the legislation. Let me ask each of you whether I have interpreted correctly as I have heard you testify.

OPPOSED TO INDEXING

That idea, Ms. Chamberlain, would you go through the indexing thing again, the reasons why you feel that this is inappropriate?

Ms. CHAMBERLAIN. Yes. I think Governor Teeters expressed it very, very well, that the discount rate is not a market rate; it is an administrative rate. It is a rate which, in fact, is designed to discourage commercial banks from borrowing. It has nothing to do with the market. For that reason we feel that would be an extremely bad index to use.

Senator LUGAR. Ms. Barefoot?

Ms. BAREFOOT. Yes. We see it the same way. We do oppose any indexing and would prefer to see a free market rate. If an index is chosen, we would oppose the discount rate for the reasons that have been stated, and for the fact that it could introduce political pressures into the setting of the discount rate, which would be an additional problem. We have thought that a possible solution might be to use a set of indices tied to Treasury obligations of similar maturities to the loans that would be covered, but we have not really addressed the details of how that would work.

Senator LUGAR. Mr. Silverberg?

Mr. SILVERBERG. Yes; we would agree essentially with what has been said. I think we also indicated that the surcharge inclusion is another dimension of this; in fact, even a more extreme one, because the surcharge is something that could conceivably come on and off in rather large blocks, and most changes in the discount rate have been 1 percent or less. The surcharge could conceivably be eliminated at one point in time, and result in a rather drastic change.

CONSUMER PROTECTION WARNING SIGNAL

Senator LUGAR. Thank you. Now, Ms. Barefoot and Mr. Silverberg have both commented, as they took a look at the consumer protections, that they saw certain preemptions there that we ought to take a look at, and I appreciate that comment and I ask the staff to look very carefully at that situation. The initial presentation of the act, of course, tried to make certain that consumer protections were not preempted in broad categories.

I cite at least the language which we tried to explain, that section 531 preempts all State usury laws in connection with extensions of consumer credit made by a creditor. This section depends heavily on definitions contained in section 532. In effect, this provision does away with all rate ceilings and mechanisms that attempt to limit the types of and rates of charges that may be assessed in connection with consumer credit transactions. But it does not extend to state consumer protection laws that deal with restrictions, limitations, or prohibitions against certain types of credit

activity. And the rest of the explanation goes on to indicate all of the things which it does not preempt.

I gather from the testimony of the two of you that you see some problems here, and I would like to explore that a little bit further. Mr. Silverberg, can you be more explicit as to the areas?

Mr. SILVERBERG. I am afraid I can't be, Senator. Our attorneys looked at the provision and I think felt some sense of ambiguity, some disagreement among them whether or not there would be this sweeping away or not. So I think it was a question of our having some concern in this area; we are not certain.

Senator LUGAR. You simply are raising a warning signal.

Mr. SILVERBERG. That's correct.

Senator LUGAR. Do you have any further comment, Ms. Barefoot, on that?

Ms. BAREFOOT. I would agree that we are concerned about the ambiguity. The definition of covered charges under consumer credit is "interest discount points, time price differential, fees, charges, or any other compensation paid to the creditor or arising out of the credit agreement or transaction for the use of credit or credit services." The definition goes on to exclude fees arising out of the debtor's failure to comply with the contract, such as late fees, I would presume. That is a very sweeping, rather open-ended description of the charges that were covered, and we were not sure how it would apply to insurance premiums, credit life insurance, provisions covering the rule of 78 rebate method and so forth. It seems that it might be worthwhile to clarify further exactly what items would and would not be covered.

One possibility might be to have the preemption specifically address the items which are included in the APR and finance charge under truth in lending, which are interest-related in their nature, and to exclude other types of charges.

Senator LUGAR. Those are very helpful suggestions and we will ask the staff after these hearings, to check very carefully with that. We appreciate your bringing that to our attention in these hearings.

I have no further questions for you. Other members of the committee may, in due course. If they do, would you be available and willing to answer questions of other Senators at a later date?

Mr. SILVERBERG. Yes.

Ms. CHAMBERLAIN. Yes.

Ms. BAREFOOT. Yes.

Senator LUGAR. We must recess the hearing briefly to go vote. We have a rollcall vote on, and absent any other relief in a relay race of sorts, we will simply recess for a few minutes and we will be back and we will have one additional panel at that point.

[Recess.]

Senator LUGAR. The hearing is called to order again.

We will now have a panel of: Representative Roger Begin, State Representative of Rhode Island, on behalf of the National Conference of State Legislatures; Assemblyman Bruce Young, State Assemblyman of California; and Kathleen Goodpasture Smith, South Carolina Department of Consumer Affairs, on behalf of the American Conference of Uniform Consumer Credit Code States.

STATEMENTS OF REPRESENTATIVE ROGER BEGIN, STATE REPRESENTATIVE, RHODE ISLAND, REPRESENTING THE NATIONAL CONFERENCE OF STATE LEGISLATURES; ASSEMBLYMAN BRUCE YOUNG, STATE ASSEMBLYMAN OF CALIFORNIA; AND KATHLEEN GOODPASTURE SMITH, SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS, REPRESENTING THE AMERICAN CONFERENCE OF UNIFORM CONSUMER CREDIT CODE STATES

Senator LUGAR. We [1] are grateful to each one of you for coming some distance to be a part of this hearing. I would like for you to testify in the order that you were introduced.

First of all, Representative Begin, Rhode Island.

Mr. BEGIN. Thank you, Senator.

I thank you for this opportunity to submit a statement for the hearing today on S. 1406 and S. 963, bills purporting to increase the availability of credit.

My name is Roger Begin. I am a Rhode Island State representative and deputy majority leader of the Rhode Island House. I also serve as chairman of the NCSL's Government Operations Subcommittee on Financial Institutions. It is in that capacity that I address you today.

The National Conference of State Legislatures is the official repesentative of the Nation's 7,500 State lawmakers and their staffs, and as a member of that organization, I must tell you today that we are, quite simply, quite irrevocably opposed to these bills. S. 1406, in particular, is one of the most blatant assaults on federalism, State's rights, and the States' capacity to protect its residents in this century. The irony is that these bills are being clothed in a shroud of benevolency and concern for business and consumers.

I would like to address our views principally to S. 1406, since my remarks by implication would also apply to S. 963.

From previous testimony, it seems there is a great deal of concern about the State of Arkansas' economy and its 10 percent usury ceiling, set by constitutional mandate. Arkansas' voters have consistently refused the opportunity to raise the usury ceiling. Despite the opportunities for consumer groups and creditors to educate Arkansas consumers on the advantages and disadvantages of the 10 percent usury ceiling, Senator Proxmire has perceptively noted that it is virtually impossible to get people to vote for higher interest rates. As an organization of politicians, we most certainly agree.

HOLDING THE COUNTRY HOSTAGE

When people are presented with a choice of higher interest rates or lower interest rates, people will vote for lower interest rates. We do not envy the mission of creditors and business people in Arkansas. However, because the people of Arkansas have chosen not to raise their usury ceilings, you cannot hold the rest of the country hostage. I submit that through the passage of S. 1406, Congress

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[1] National Conference of State Legislatures gratefully acknowledges the assistance of Louis Kozloff, executive director of consumer affairs committee, Pennsylvania Legislature in the preparation of this testimony

would place every State in the Union in the same unenviable position as the creditors in Arkansas.

DIVESTITURE OF POWER FROM THE STATES

This bill would permanently force every State to accept whatever the market will bear in interest rates, and provide scant opportunity to reject this assault on local economies through a so-called override provision. However, even if the override provision was something more than a no-win proposition for most States, our major concern about S. 1406 is the outrageous divestiture of power from the States.

To apprise you of the intensity of our opposition to preemption in this area, you should know that in 1980, a year which contained some of the most dramatic fluctuations of interest rates in this country's history, the National Conference of State Legislatures adopted a policy which opposes Federal preemption of State interest rates. I quote from this policy, in part:

> In seeking solutions to these perplexing problems, States are pursuing a variety of monetary and fiscal policies, including, but not limited to, upward adjustment of usury rates. While we recognize similar objectives in the Congress and executive agencies, we feel strongly that States should have maximum flexibility in developing their economies. We, therefore, strongly oppose any Federal legislative or executive action which would permanently or temporarily preempt State interest ceilings.

The Congress would create a very serious, probably irreparable situation with the passage of this bill. Only State legislators have the experience to decide what the level of competition is in their States. The Federal Government does not have that expertise, and it could only be developed after the expenditure of a great deal of time and millions of dollars. The expenditure would be wasted, because the expertise already exists in a virtually untapped resource—the Nation's State legislators. State legislators are more likely than any other member of State government to be held accountable for their decisions by the people they represent. More importantly, they have to live with the result of their decisions. State legislators can best decide where competitive markets exist and where they do not exist. In making these determinations, they cannot afford to advocate the interests of only bankers, creditors, or consumers. Everyone's interests have to be balanced, and while the end result of the balancing processes seldom pleases everyone completely, more often than not, everyone affected can live with it.

You have heard complaints from creditors and bankers that the State usury laws create a patchwork of different regulations in the country and that the laws are very complex. Well, there's a very good reason why the State's usury laws are complex: Different levels of competition exist in the retail area, the business area, agricultural area, and the mortgage area. Thus, there are different ceilings for different transactions in the States.

Different lenders lend to different risk categories. Where one lender may decide not to lend a customer money for a car loan, another creditor may decide to issue the same customer a charge card. There are a myriad number of variations on this theme of competitive levels. Only State legislators can be sensitive to these variations on the need for competition.

The Wisconsin Office of the Commissioner of Banking has recently released a survey of the maximum finance charges for primary mortgages, closed-end credit, open-end credit, and finance company consumer credit for all States. To demonstrate the nuances that exist in the States' economic fields, I'd like to quote some findings from the report.

A State like Texas has no ceiling on primary mortgages, due to enactment of Public Law 96-221, but in the closed-end credit, open-end credit, and finance company areas, the ceiling is indexed to twice the 6-month treasury bill rate, not to exceed 24 percent per year. The legislators in Texas set those ceilings in that manner for a reason—they are a response to the level of competition in those markets. In Indiana, there is no ceiling on primary mortgages, but in the area of closed-end credit, interest rates range from 36 percent to 15 percent, depending on the outstanding balance. However, in the open-end credit area, the ceiling is 18 percent per year, with a 50-cent minimum finance charge. However, for finance company convenient credit rates, the ceiling is the same as that listed for closed-end credit. In Utah, there is no ceiling on primary mortgages, but in the area of closed-end credit, the ceiling ranges from 36 percent to 15 percent, depending on the outstanding balance. Utah has no ceiling on retail credit, but an 18-percent ceiling on bank cards exists, with a 50-cent minimum finance charge.

LEGISLATION IS INFLATIONARY

The differences between Texas, Utah, and Indiana should make one thing crystal clear: The flow of capital differs markedly from one State to another. You've heard witnesses testify that money is not only an interstate commodity but an international commodity. Those witnesses are absolutely right. However, despite the international flow of capital, money flows differently, not only from region to region, but from State to State. Moreover, money flows differently among large cities, small cities, and rural areas. Most importantly, it is perfectly natural for capital to flow differently in one State than in another. This legislation would obliterate these valid and natural differences with one broad sweep. The capital market that exists inside the borders of a State is a valid market that must be recognized by the U.S. Congress, even as they recognize that capital may flow beyond a State's or a country's borders. It is vital to recognize that in areas where there is little or no competition, deregulation would cause artificially high rates that would be economically detrimental to the State's communities. Creditors would take too great a share of the consumer's disposable personal income. This legislation is also inflationary and would hurt the business community as well as consumers.

As a State organization, we're not comforted because the legislation would not preempt a State's rights in certain areas of consumer credit. The bottom line is that jurisdiction over interest rates is the single most important method to provide a compatible climate for business and consumers. Without the ability to determine what is usurious, many of the protections that States provide to consumers will have limited effect. It has been suggested that States could regulate what's left of the field through consumer licensing requirements. The major problem with that solution is that licensing

has a limited purpose. Licensing is required of practitioners so that a State may determine that those who desire to enter an occupation possess the minimum skills required to carry on that occupation competently. Consumer licensing laws were not designed to accomplish any more than that. After the licensing, there is still the matter of regulating those who legally practice the occupation, to make sure that they do not violate the confidence that other professional members, as well as the public, place in them. In the area of credit, the most efficient way to do this is through usury ceilings. A usury ceiling is a State's way of declaring that given the economic conditions that exist in the State, most importantly, the level of competition, and given the duty to protect consumers and to equalize the negotiating process between creditor and debtor as much as possible, interest rates charged above a certain level are unconscionable.

Another frightening aspect of this preemptive bill is that under the generic term "covered charges," a host of other types of fees are included, thus permanently removing another area of regulation from the States. In addition to interest rates, discount points, time-price differential fees, transaction fees, access fees or any other fees a creditor could dream up may beadded to the cost of credit under this bill if they are either connected to the cost of credit or are service charges.

The States that do not allow the imposition of those fees have made an affirmative policy decision that the imposition of those fees is not in the best interests of the economic climate of that State. State legislatures are much more sensitive to what is the best approach to foster economic prosperity in their States, but in one broad sweep, you strip States of the power not only to determine what is an unconscionable rate of interest, but even what an interest rate is. The cost of revising consumer licensing laws to replace the vacuum that would be left by this legislation is not justified by this situation.

An eloquent demonstration of this is that most States have reconsidered their usury ceilings, rejecting the need for this legislation. Twenty-six States have usury ceilings in the area of open-end credit transactions that are at 21 percent or above. Fourteen States have removed ceilings on retail or bank card credit in the open-end transaction area.

There has also been activity in the primary mortgage area, and the closed-end area, as well as the consumer finance credit area. The States have had to respond due to the effects of deregulation caused by the Depository Institutions Deregulation and Monetary Control Act of 1980, as well as other economic factors.

Upon perusing the report issued by the Wisconsin office of the Commissioner of Banking, you will notice that some States have one usury ceiling that applies in, for example, the closed-end credit area; some States vary the ceiling depending on the outstanding balance; and some States index the ceiling to the interest rates paid on Government securities; while other States require a minimum finance charges that ranges from 50 cents to $1. Economists have very strong opinions about the utility of indexing interest ceilings or varying interest rates based on outstanding balances. One fact has been clear throughout the debate: No one has the

answers. There is a great deal of experimentation that is going on in the States. We, as State legislators, recognize that the answer may not be one approach, especially with the various markets that exist in this country. This experimentation is invaluable and could never be duplicated by the Federal Government. Yet, enactment of this bill would eliminate this experimentation permanently.

The override provision in this bill is not an option for the States. Many State legislatures are part time and some meet once every 2 years. Until a State is able to override the Federal preemption, all the elements of this deregulation go into effect. It would be extremely difficult for a State to reinstate its interest ceilings after up to 2 years of a deregulated market. It is so difficult that this option is really no option at all. However, let me hasten to say that even if this override option was more realistic and the preemption was temporary, rather than permanent, we would be opposed to this legislation.

CREDIT SUPPLY

We also take exception with the perception that people are unable to get credit. If people have trouble getting credit, rest assured that State legislators would be among the first to be notified. I have not gotten complaints from any constituents about the supply of credit. The staff of NCSL has not received any complaints, either. Credit is available, but due to inflation, as well as concern over high interest rates, demand for credit is probably not as high as creditors would like. People are more careful about obtaining charge cards and try to incur a minimum amount of debt.

We also think there are two sides to the Arkansas story. You have heard evidence from the Consumer Federation of America that credit is about as available in Arkansas as in other parts of the country. The people of Arkansas have had several chances to consider their usury ceiling and they have decided not to change it. Despite the difficulties inherent in the issue, they are probably better educated on this subject than many other people. Congress may not like the way the vote came out, but it would be a serious breach of federalism principles to force the people of Arkansas and the other States to accept this legislation because Congress believes the people voted the wrong way.

I thank you for the opportunity to testify on S. 1406 and S. 963. We strongly urge you to reconsider this legislation, and to undertake a nationwide study of competition, not only on a State-by-State basis, but on a market-by-market basis, before you eliminate anything as delicate as the balance exemplified by the State's usury ceilings.

Thank you again. I will be glad to answer any questions the committee might have.

Senator LUGAR. Thank you very much, sir.

I would like to call now on Assemblyman Bruce Young of California.

Mr. YOUNG. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you and share some of my personal observations, made after 5 years of extensive

investigation and involvement in California's consumer credit regulation.

During my tenure in the California State Legislature, I have made it somewhat of a specialty to concentrate on the areas of banking and insurance law.

In that capacity, I have served as vice chairman of the State assembly's finance, insurance and commerce comittee for 4 years, and am currently a member of the subcommittee on financial institutions. I am also a member of the Conference of State Legislators.

With that background, I want to state I come before you today sincerely seeking your support for Senator Lugar's S. 1406, which would deregulate consumer credit interest rate ceilings while preserving each state's right to establish and regulate consumer protections, licensing requirements, and standards of supervision.

I would have found the notion that I would support deregulation of retail credit totally unfathomable and unthinkable 5 years ago when I first began my legislative career.

I initially approached the entire subject of credit deregulation in a very superficial manner, rejecting out of hand any thought of removing California's usury limits, which impose either an 18 percent or 21.2 percent limit, depending on the transaction.

However, after 5 years in the practical application of our legislative mandates and restraints, I find that our theories in California of protecting the consumers with artificial and outmoded usury laws were cures worse than any known disease.

ANTIQUATED USURY LAW CAUSE HARDSHIPS AND MISERY

I soon discovered that our legislative stonewalling and protection of an antiquated usury law only translated into hardships and misery for California consumers who had to obtain credit for needed and necessary purchases.

I found out that we in the legislature could not make the cost of money stand still any more than we could halt the rotation of the Earth. Thus, our consumers were forced to resort to much more costly and unacceptable alternatives to obtain sufficient credit.

This, unfortunately, included obtaining loans where household furnishings, automobiles, and literally every worldly possession were put up as collateral; and then, even more tragically, repossessed in the process of default.

Thus, a consumer was left with a far more dramatic impact of having their furniture stripped from their home, or an essential automobile repossessed, simply because we in the legislature forced them to turn to alternative sources rather than the traditional retail outlets for credit.

We also found that our unrealistic credit limits spawned, if indeed that's what sharks do, a new industry of predatory loansharks, who operate outside the laws and do not provide even the most basic consumer protections and disclosures that our traditional creditors must offer under California and Federal statutes.

When turned away by mainstream retail credit operation for vital purchases, we found that California borrowers sought other sources and found themselves easy prey for loansharks, where 100- and 200-percent interest was the rule, not the exception.

I must also confess that many of us in California who blindly stonewalled usury laws were guilty of gross arrogance at the very least, and more appropriately, economic elitism.

We rationalized that usury laws protected the ignorant and, quite simply, our sole mission on Earth was to save the consumer from themselves, a thought process that today seems fit for the ostrich cage in the zoo. Quite literally, we were ready to fight to the last consumer to protect them from themselves.

One witness testified before the California Legislature that all of us in the legislative branch were being smug and insensitive to the problems of a typical consumer who must have credit, but cannot obtain it through traditional sources. She felt it was tantamount to crossing the river and then raising the bridge so no one else could follow.

Another one of my constituents told me she appreciated the usury protection that we provided, but asked that I stop the assistance because she couldn't afford my help any longer.

My constituent said she could no longer afford to turn to pawnbrokers, personal property brokers, or loansharks every time her refrigerator broke or she desperately needed an automobile to get to work. Basically, she asked me to help the affluent because they could afford the legislature's help.

We in the California Legislature were constantly counseled by consumers that our obligation in government should be fulfilled when we assure that the consumer is fully and completely informed so that they—not some distant, unseen, self-appointed governmental savior—can make the rational and fair decision about a credit transaction.

The most abrupt lesson we learned over the past 5 years was that those most severely impacted by impractical usury laws were the very low- to moderate-income consumers. these were the very consumers we sought so righteously to protect from themselves.

In our deliberations, we found that when interest rates soared beyond the usury limits, retailers across the State immediately raised their credit threshold, thus compelling those on the lower end of the economic ladder to search elsewhere for more expensive alternatives.

We literally spawned a wave of economic discrimination that ironically hurt those who needed credit the most.

We also discovered that the true cost of money was passed on to the consumer in a much more indirect and certainly not disclosed fashion.

In fact, we found that in California the cash purchase customer was subsidizing the losses in retail credit through higher prices.

As I stated, the premise of California consumer protections is based firmly on the fact of full and complete disclosure. This hidden, yet understandable, pricing practice by retailers made somewhat of a mockery of our full disclosure.

If a retailer loses $1 or $100 on each credit transaction, he or she can't make that up in volume. They must raise prices to compensate somwhere and somehow. Thus, the cash customer was paying higher prices, beyond the worth and value of the actual goods.

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I also want to dispel the notion that this measure, or any deregulation bill, is simply an effort to benefit large banks or financial institutions.

On the contrary, we moved aggressively in California because we found the disadvantage fell disportionately on the backs of the small retailer.

We in public life and the press always banter about the importance of prime rate as a benchmark, yet most California small retailers only see the word "prime" on a piece of good meat.

These small businessmen and women often have to borrow at two to three points above the prime rate and find themselves paying 22 or 25 percent for their money, yet are limited to a return of only 18 percent by California usury laws.

This led to another phenomenon that I predict will happen nationwide if we don't act swiftly, and that is large banks will corner all the credit transactions through their charge card operations.

On the surface, that may not sound too threatening, but we also unearthed another hidden cost to the consumer in this process. In our State, retailers were asked to pay 6 to 10 percent additional markdown to the credit card companies for using their service, which ultimately means the cost of goods to the consumer must be increased by a like amount in an undisclosed manner just to offset this expense.

BANK CREDIT CARDS UNREGULATED

Additionally, in California, bank credit cards are unregulated so they would, and did, charge higher rates, because there was no competition from retailers who would offer lower rates simply because they do not need to make a profit off their credit operation and would provide more favorable rates because it was a marketing tool to attract customers.

Indeed, the real thrust of stringent usury laws is to unfairly impact small business people and threaten their very existence or, at the very least, force them to totally deed all credit operation to a few large financial institutions, something we in California found totally unacceptable.

As a beginning step in dealing with this problem in California, I successfully authored legislation last year that may ultimately lead to the elimination of rate ceilings in consumer credit transactions involving consumer goods and services.

My bill, AB 3371, increases the maximum finance charge which may be imposed on retail installment contracts and accounts.

Under preexisting law, the maximum finance charge which may be imposed on a retail installment contract in California, determined by the precomputed basis, is 5/6ths of 1 percent on the first $1,000 plus 2/3rds of 1 percent on that above $1,000; and on a retail installment account in California, up to 1 1/2 percent on the first $1,000 and 1 percent on that over $1000, computed on the outstanding balances from month to month.

AB 3371, which is now law in California, increases these amounts, respectively, to 11/12ths of 1 percent and 1.6 percent on the first $1,000, for a period of 15 months, after which time the law reverts to the existing ceilings unless the legislature acts differently in the meantime.

I believe title III is necessary for dealing with the elimination of consumer usury ceilings. Enactment of title III would permit the boards of directors of individual Federal credit unions to determine what rate of interest would be most appropriate to meet the borrowing needs of their members, unhampered by an artificial ceiling dictated by statute.

I must agree with the views expressed before this subcommittee by the National Association of Federal Credit Unions that it makes infinite sense for the Congress to begin by eliminating the one consumer usury ceiling that is within its own exclusive jurisdiction.

In closing, let me say that, with all due respect to my fellow Americans in Arkansas, there has been too much emphasis placed upon their unique problems and a tendency to portray it as only an isolated problem of one area verus a national dilemma.

Hailing from this country's largest State, I want to tell you the problem is just as real and almost as dramatic in California as it is in Arkansas or any other State with an outdated usury law.

This is a national problem that does not begin or end at the Arkansas or California borders. It must be answered by a national law.

I firmly believe that restrictive rate ceilings do not really "protect" consumers, but, rather, two undesirable effects occur:

One, restricted credit availability, especially among higher risk applicants; and

Two, higher cash prices for merchandise sold on credit to offset losses on credit.

Any interest rate ceiling at all is destined to become obsolete because of rapidly escalating costs in all areas—cost of borrowed funds, payroll, bad debts, and collection, postage, equipment, et cetera.

A lowering of prime rates—or money cost—may bring a temporary respite, but it does not eliminate the long-range problem presented by ever-increasing costs in all areas of credit operations.

The only long range, permanent solution is to foster competition among credit grantors, fully inform consumers of the true cost of credit—without burying part of the cost in higher merchandise prices—and let market conditions alone determine the rates of charge to be imposed. Rate ceilings—of any kind—are doomed to create problems, eventually causing a continual need to reevaluate and rehash old arguments.

The marketplace can work—if allowed to—and consumers can choose for themselves whether or not the cost of a credit service is worth the price—unless that cost is buried in the price of the merchandise.

In my mind, the remedy to this and even more acute problems within our retail credit system rest with Senator Lugar's S. 1406. And I urge your immediate passage of the measure.

Senator LUGAR. Thank you very much, Assemblyman Young. I would now like to call upon Ms. Smith. Would you please testify?

Ms. SMITH. Mr. Chairman, thank you for this opportunity to appear before this subcommittee.

My name is Kathy Smith. I am speaking on behalf of the American Conference of Uniform Consumer Credit Code States, as chair-

man of its legal committee and also for the South Carolina Department of Consumer Affairs as counsel to the administrator.

The department of consumer affairs, among other things, administers and enforces the South Carolina Consumer Protection Code, South Carolina's version of the Uniform Consumer Credit Code.

The conference currently is made up of eleven States that have adopted the Uniform Consumer Credit Code, which I will refer to as the UCCC—Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming. We expect the conference to grow as more States adopt the UCCC, if Congress does not further preempt consumer credit laws.

Usurpation of a State's power to regulate credit through preemption lessens a State's incentive to modernize its credit laws. Since this is a brief summary, we request that our full written statement submitted earlier be placed in the record.

Senator LUGAR. Without objection, so ordered.

Ms. SMITH. We oppose both S. 1406 and S. 963. I will focus on the consumer credit provisions in title II of S. 1406 because it contains the more sweeping Federal preemption of State consumer credit laws.

INTRUSION BY THE FEDERAL GOVERNMENT

First, we are opposed because Federal preemption of State consumer credit laws is an intrusion by the Federal Government into an area traditionally and better left to the States. The code States all have a version of the UCCC, which is a carefully balanced code drafted by the National Conference of Commissioners on Uniform State Laws. Each State has tailored the UCCC to its own special needs while maintaining a degree of uniformity among them. UCCC has a relatively high rate ceiling on finance charges—36 percent on small loans—to permit credit to be legally available to high-risk consumers while allowing competition for the more creditworthy consumer below the rate ceiling.

One of the four assumptions on which the UCCC is based is stated in the regulatory language as follows: "For competition effectively to determine the pricing of money and credit requires for the protection of less knowledgeable and less sophisticated credit recipients ceilings on the price of credit, restrictions on creditors' rights and remedies, and enhancement of debtors' rights and remedies sufficient to prevent overreaching by creditors without unduly limiting the availability of credit."

Limitations on rates and charges are carefully balanced with the availability of rights and remedies to both consumers and creditors in the UCCC. Tampering with rates and charges invariably affects rights and remedies.

The National Conference of Commissioners on Uniform State Laws said in 1969 that

> The provisions in the UCCC governing ease of entry into the market, uniform disclosure of costs and terms, rate ceilings, restriction of creditors' rights and remedies, enlargement of debtors' rights and remedies, and powers granted to the administrator of consumer credit are so inextricably interrelated that any substantial change in one area requires a major review of the balance struck in all other areas.

This acknowledgment of the interrelationship between rates and charges on the one hand and rights and remedies on the other was echoed by the National Commission on Consumer Finance in its report to Congress in December 1972. That Commission was created by Congress in the Consumer Credit Protection Act to study and appraise the functioning and structure of the consumer finance industry as well as consumer credit transactions generally.

We submit that the code States are regulating consumer credit in a way that is fair to both consumers and creditors and that this regulation is working. To preempt the UCCC and upset the delicate balance in our State would destroy our ability to regulate consumer credit.

While S. 1406 is apparently intended to be a limited preemption, it is not so drafted. It is almost total preemption, and what little would be left of State laws is so minor that to pretend to regulate after the preemption would be only a sham.

The definition of "covered charges" which are preempted is so broad that it covers every conceivable kind of charge in any way connected with the transaction, no matter to whom paid—not only finance charges but insurance charges, prepayment penalty charges, deferral charges, and many additional charges. The only category of charges that is free from preemption is for default, which includes very few charges under the UCCC.

The provision to preserve licensing is only a mirage. First, under the UCCC, most creditors need not be licensed at all. S. 1406 would allow these creditors to make any charges whatsoever, and the code States would be powerless to supervise them.

Second, even for those obtaining a license, there would be very little left for the regulatory agencies to supervise, because most of the substantive consumer protections in the UCCC are charge-related. No doubt the time that is currently needed for supervision of creditors would be taken up answering consumer complaints about charges and practices that would develop after State laws were preempted. The preemption would leave us no authority to resolve such complaints.

Although there is supposedly the opportunity for States to override Federal preemption, this part of S. 1406 is illusory as well. Override, itself, is a cumbersome, demanding process. The majority of code States have already overridden Federal preemption. For example, South Carolina, has twice in the last year and a half but will be required to do so yet again. How many times must a State reassert its power before it gives in to the inevitable Federal takeover?

Even when a State successfully overrides, there will invariably be a period of preemption, resulting in chaos in the credit marketplace. During that period, variable rate transactions entered into prior to preemption can nonetheless vary without regard to State law after preemption. Worse yet, even after override, preemption continues for open end credit for 18 months.

Next, we believe that the premise on which this bill is based is false. It is argued by some that a cause of our current economic predicament is low rate ceilings. We submit that the cause is high rates, not the fact that ceilings exist or not.

My State of South Carolina is a good example. We regulate consumer credit under the UCCC with rate ceilings and other restrictions on charges, yet consumer credit has expanded every year under the UCCC. The number of licensed supervised lenders has increased every year. This is in direct contrast to what is happening in the home financing market. Even before preemption of State laws governing rates on first mortgage home loans under the Federal Deregulation Act, in 1979, South Carolina completely removed rate ceilings on such loans.

But look what happened. Home financing in South Carolina has fallen off dramatically since 1979, and certainly not because rate ceilings are too low. There are none. At some point, consumers cannot or will not finance purchases because the rates themselves are too high.

IMPACT OF PREEMPTED CONSUMER CREDIT LAWS

Finally, we believe that everyone would lose if Congress preempted State consumer credit laws. States would lose their power and ability to regulate consumer credit and protect their own consumers. Consumers would lose the protection they enjoy under modern laws like the UCCC and would once again become victims of loan sharking and other types of overreaching by some creditors. Creditors would lose the ability to work with local legislatures and regulators to iron out problems that develop in local markets and would probably once again earn a reputation for gouging and gimmickry which brought about so much consumer credit legislation in the first place.

Consumers would then look to Congress for help. And when they do, you will be faced with a choice of passing comprehensive legislation covering all aspects of consumer credit, much like a Federal UCCC, with a resulting new Federal bureaucracy or returning the power to regulate consumer credit to the States where it is now.

For these reasons, we respectfully oppose S. 1406 and S. 963.

I will be happy to try to answer any question you have. Thank you.

[Complete statement follows:]

STATEMENT OF KATHLEEN GOODPASTURE SMITH
ON BEHALF OF
THE AMERICAN CONFERENCE OF UNIFORM CONSUMER CREDIT CODE STATES
AND
THE SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
BEFORE
THE UNITED STATES SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
HEARING ON S 1406 AND S.963
TUESDAY, JULY 21, 1981

The American Conference of Uniform Consumer Credit Code States ("the Conference") is an organization of States which have a version of the Uniform Consumer Credit Code ("UCCC"), currently Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming. The South Carolina Department of Consumer Affairs is the State agency which administers and enforces South Carolina's version of the UCCC, the South Carolina Consumer Protection Code. The original UCCC was drafted and adopted by the National Conference of Commissioners on Uniform State Laws in 1968. Two States adopted the UCCC in 1969 with other States following including South Carolina in 1974. Given the opportunity, more States may adopt a version of the UCCC which could lead to State consumer credit laws being uniform in the same way that the Uniform Commercial Code has provided uniformity in the area of commercial law in 49 states. Federal preemption begun by P.L. 96-161, continued in The Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221 as amended ("Deregulation Act"), and proposed to be extended by S.1406 and S.963 frustrates the ability of States to enact and enforce their own modern credit laws such as the UCCC which are the result of careful consideration and balancing of creditors' and consumers' interests in a particular State.

Among the purposes and policies of the UCCC are to provide rate ceilings to insure an adequate supply of consumer credit, to foster competition so that consumers may obtain credit at reasonable cost, to protect consumers against unfair practices by some suppliers of consumer credit, and to permit and encourage development of fair and economically sound consumer credit practices. 1968 UCCC §1.102.

The rate ceilings in the UCCC are intended to be adequately high to allow high-risk consumers to obtain credit from legitimate sources while providing competition below the ceiling for credit extended to other consumers. Thirty-six percent

annual percentage rate is the maximum allowed for small consumer credit transactions under the UCCC with a rate ceiling that decreases (other than in some open-end plans) as the amount of the transaction increases. 1968 UCCC §§2.201, 3.201, 3.508. Dollar amounts in the UCCC are tied to the Consumer Price Index with the result that amounts have increased generally with inflation as illustrated by Utah whose dollar amounts have increased 120% since the UCCC's enactment there in 1969 1968 UCCC §1.106 As an alternative to graduated rate ceilings which depend on the size of the transaction, a creditor may choose the flat rate maximum which is 18% in the UCCC but has recently been changed to 21% annual percentage rate in Colorado, Idaho, Indiana, Oklahoma and Wyoming. Other States are considering an increase such as South Carolina which has two bills to increase this flat rate maximum to 21% (H 2440) or 24% (H.2604). Some open-end transactions are currently subject to a maximum of 24%. 1968 UCCC §2.207.

Besides providing realistic rate ceilings, the UCCC contains numerous provisions dealing with rates and charges in connection with consumer credit transactions. State rate and charge limitations are so completely intertwined with consumer protection provisions that the two concepts cannot be separated. The philosophy of the UCCC is that with higher rate ceilings more consumer protection provisions are necessary. The reverse is also true. In other words, when creditors have the legal authority to charge higher rates, a State must assure that this authority is not abused and therefore should have restrictions on other charges and terms of the consumer credit agreement as well as practices and remedies connected with the transactions. Likewise, the more restrictions that are placed on creditors, their ability to charge higher rates if necessary for high-risk consumers must be assured to cover any additional expenses as a result of consumer protection provisions. The UCCC thus provides a delicate balance between creditors' and consumers' interests which, if tampered with, upsets the entire regulatory process. Thus the Conference has unanimously passed two resolutions, Resolution 1-80, attached to the statement of Prescott H. Cowley, President of the Conference before the United States Senate Committee on Banking, Housing and Urban Affairs during the oversight hearings on financial institutions on Thursday, May 7, 1981 and more recently Resolution 1-81 of May 23, 1981 opposing H.R.2501 "and any other similar legislation that would preempt any part of the Uniform Consumer Credit Code" including S.1406 and S.963, copy attached.

IMPACT OF S.1406 ON THE UCCC AND S. C. CONSUMER PROTECTION CODE

S.1406, the "Credit Deregulation and Availability Act of 1981," is patterned after H R.2501, the "Interest Rate Deregulation Act of 1981," introduced March 12, 1981. Title I of both bills concerns business and agricultu--l credit. The intent of the UCCC is to generally deregulate business credit (1968 UCCC §§2.605, 3.605) and the UCCC States have acted on their own to exclude agricultural credit from the UCCC's regulation (e.g., S.C. Code Ann §37-1-202(8) (1976 as amended)). Although we believe that even business credit deregulation is the province of the States and not the federal government, this statement principally concerns Title II preempting State consumer credit laws. However, §101 of S.1406 contains a trouble-some definition of "business credit" in §511(c) to include credit extended primarily for "investment" purposes "Investment" is not defined and we fear that it could be interpreted to cover some transactions UCCC States may conside to be primarily for personal, family or household purposes and therefore consumer credit. A consumer's "investing" in a money market certificate or a duplex in which he resides may nonetheless be for a personal, family or household purpose for example, and therefore when financed may result in an extension of consumer credit governed by the UCCC. Is S.1406 trying to define certain transactions which States have determined to be consumer credit as business credit instead? The question raised by this definition illustrates potential problems in this type of federal pre-emption legislation which appears to affect one type of transaction but may, in fact, affect others.

Title II of S 1406 would amend Title V of the Deregulation Act by adding a new Part D on consumer credit containing §§531 through 534 in §201. Section 531 generally would preempt State law "prohibiting, restricting, or in <u>any way limiting</u> the rate, <u>nature</u>, <u>type</u>, <u>amount of</u>, or the <u>manner of calculating</u> or providing or contracting for <u>covered charges</u> that may be charged, taken, received or reserved" in connection with an extension of consumer credit made by a creditor. (Emphasis added) "Covered charges" is defined very broadly in §532(a)(1) to include "interest, discount points, time price differential, <u>fees</u>, <u>charges</u> or <u>any other compensation</u> paid to the creditor or <u>arising out of the credit agreement</u> or transaction for the use of credit or credit <u>services</u>." (Emphasis added) That broad definition of covered charges then excludes "fees, charges or other amounts

paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement." (Emphasis added) Thus the definition of covered charges is broad enough to include all fees and charges arising out of a credit transaction while the exclusion from that definition is very narrow and is limited to those charges arising only as a result of the consumer's failure or refusal to comply with the agreement.

The only charges governed by the UCCC which are apparently unaffected by the preemption of S.1406 would be default charges because the failure or refusal to comply with the terms and conditions of a consumer credit agreement ordinarily results in a default. 1968 UCCC §§2.414, 3.405, 1974 UCCC §5.109. The UCCC limits the charges that may be made as a result of default to only those specifically authorized such as reasonable expenses incurred in realizing on a security interest and reasonable attorney's fees not in excess of 15% of the unpaid debt after default and referral to an attorney not a salaried employee of the creditor. 1968 UCCC §§2.413, 3 404, and 3 514, the last prohibiting attorney's fees altogether in certain small high rate loans. Thus charges for attorney's fees and expenses related to a security interest would apparently still be governed by the UCCC.

It is much less clear that delinquency charge limitations would not be preempted. In many cases it is understood and even anticipated that a consumer may be somewhat late in making his payments in which case he would be expected to pay an agreed-to late charge 1968 UCCC §§2 203, 3.203. It is questionable whether paying an instalment late plus any resulting delinquency charge is a "failure or refusal to comply with the terms and conditions" of the transaction It could be argued that paying in this manner is actually compliance with the terms and conditions of the transaction rather than a failure or refusal to comply. Under such an interpretation, the delinquency charge provision would be preempted along with numerous other provisions.

UCCC provisions governing fees and charges arising out a credit agreement which are not as a result of the consumer's default or failure to comply with the agreement and would apparently be preempted include the following. 1968 UCCC §§2.201,

2.207, 3.201 and 3 508 providing maximum finance charges that may be charged in connection with consumer credit sales and consumer loans; 1968 UCCC §§2.209 and 3.209 prohibiting prepayment penalty charges (although the section-by-section analysis says that provisions limiting or prohibiting the use of penalties that are imposed solely as the result of the voluntary prepayment in full of the credit transaction are not affected, the language of the bill does not lead to such a conclusion; in any event, the UCCC prohibits penalties for both voluntary and involuntary prepayment in full); 1968 UCCC §§2.210 and 3.210 limiting the minimum charge that may be retained in some instances when a consumer credit transaction is prepaid in full as well as requiring rebate of unearned finance charges, 1968 UCCC §§2.202 and 3.202 and 1974 UCCC §2.501 listing additional charges that are permitted to be made outside the finance charge including insurance charges under certain conditions and certain closing costs if they are bona fide, reasonable, and not for the purpose of circumvention of the law; 1968 UCCC §§2.204 and 3.204 limiting deferral charges (a consumer and a creditor may agree to defer instalments without a default); 1974 UCCC §3.504 requiring a seller to return a downpayment after a home solicitation sale has been cancelled; 1968 UCCC §4.107 prohibiting a creditor to charge a consumer more for insurance than the amount of the premium; 1968 UCCC §4 108 requiring refund unearned insurance premium, 1968 UCCC §4.110 prohibiting duplicate charges for insurance, and 1968 UCCC §§2.205, 3 205, 2.206, and 3 206 governing maximum charges on refinancings and consolidations All of these provisions involve "charges arising out of the transaction" and have been carefully balanced with other provisions in the UCCC.

Removal of ceilings not only on the rate of finance charge but also all other charges in connection with the transaction destroys the ability of a UCCC State to regulate consumer credit. Under the UCCC, if a creditor charges more than that allowed for additional charges, for example, the charge becomes part of the finance charge. When there is a limitation on the finance charge, there is an incentive to the creditor to charge only legally authorized and reasonable charges in addition to the finance charge To illustrate, the UCCC permits a creditor to charge a consumer an additional amount for certain types of consumer credit insurance if the insurance is voluntary and other conditions are met 1968 UCCC

§§2 202(2)(b), 3 202(2)(b). With no rate ceiling, a creditor has no incentive to make such a charge voluntary and reasonable and may instead charge an unreasonably high amount for and require such insurance as a condition of obtaining credit. Another perhaps unintended effect would result from the combination of removing the rate ceiling on a consumer credit transaction while at the same time removing the prohibition against a prepayment penalty. An unsophisticated consumer might obtain a $10,000 "home equity" loan at 50% annual percentage rate secured by a second mortgage on his home to consolidate bills that have piled up or to install aluminum siding on his home. The consumer might later discover that he had been charged an unreasonably high rate and could obtain a more reasonable rate from another creditor only to find that the first creditor charges a large prepayment penalty. The first creditor effectively has locked in the consumer to the high rate for the term of the transaction which often is many years on mortgage loans. A consumer is currently protected under the UCCC not only by a reasonable rate ceiling but also the prohibition against any prepayment penalty charge when he prepays in full.

Another example of the effect of S 1406 on the UCCC additional charge sections concerns a creditor's protection of his security interest. The UCCC allows the creditor the choice of charging for actual filing (e g., currently $4 00 to file the appropriate UCC form in South Carolina) or an insurance premium in lieu of filing _if_ the charge does not exceed actual filing costs. If there were no restrictions on such charges, a creditor could charge a consumer an unreasonably high amount for such insurance, making it profitable to insure rather than file. 1968 UCCC §§2 202(1)(a), 3.202(1)(a), 1 301(10). In conjunction with this, the UCCC prohibition against charging a consumer more for insurance than the premium charged by the insurer may also be preempted. 1968 UCCC §4.107. Under S.1406, may a creditor charge any amount for insurance regardless of the premium and regardless of its reasonableness? Although the section-by-section analysis says parenthetically that certain insurance regulatory provisions would not be affected, a reading of the bill itself does not lead one to such a conclusion

To further illustrate the effect of S.1406 on UCCC additional charge provisions, closing costs must be bona fide and reasonable in amount to qualify as permissible

charges in addition to the finance charge. 1974 UCCC §2.501(1)(b). For example, a creditor may charge a consumer for document preparation in connection with a consumer loan secured by a interest in land if that fee is not paid to the creditor himself or a person related to him. S.1406 can be interpreted to allow a creditor to charge an unnecessarily high document preparation fee and keep the money himself.

Although other illustrations could be provided for each affected section of the UCCC, we will now turn to the definition of "creditor" in Section 532(a)(3) of S.1406. It is generally the same as a creditor for purposes of the UCCC with a peculiar exclusion for a person "if, except for this part, in order to assess or collect covered charges in connection with that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanism provided by State law." What is intended to be accomplished by this is not clear The section-by-section analysis says that certain consumer protection provisions may apply to those who obtain a license and therefore apparently this bill does not wish to do away with licensing However, in UCCC States most creditors do not need to obtain a license to extend consumer credit. For those creditors who need no license (e.g., all credit sellers), would S.1406 allow them to charge <u>any</u> rates and charges without being licensed? Only <u>lenders</u> making loans in excess of a certain amount, e.g 18% annual percentage rate must obtain a license. 1968 UCCC §3.502 May a lender who wishes to remain unlicensed charge the maximum rate (e.g. 18%) and also charge any amount under other UCCC provisions that have been preempted (such as additional charges and prepayment penalties) with the result that he may charge much more under federal preemption authority and yet still not obtain a license to do so? If a lender wishes to charge exorbitant rates and charges would he be able to do so simply by obtaining a license? In essence, a license to make extortionate extensions of credit? Because most substantive consumer protections in the UCCC are charge-related, just how licensing somehow alleviates the effects of preemption is a mystery. Requiring a license without the ability to enforce the corresponding regulatory provisions makes a sham of the regulatory process while giving creditors the aura of having received the State's blessing for making such charges however high S 1406 provides

that a creditor would be subject to "applicable regulatory requirements and enforcement mechanisms," but the big question is what remains "applicable" after almost total preemption.

OVERRIDE PROVISIONS

The supposed ability of a UCCC State to override the federal preemption under Section 533(b)(1) of S.1406 is illusory. Even override itself does not always result in overturning the preemption. Section 533(b)(2) exempts open-end transactions for 18 months from the override. The incentive to creditors for entering into open-end credit transactions if State override legislation were imminent would be great. Providing that a State may override the preemption and yet preventing a State from enforcing its own laws even after override in order to protect its consumers is an affront to States' rights. Before override, variable rate transactions will be subject to preemption although entered into prior to it. Also, many States including the majority of UCCC States have already overridden federal preemption in the last year and a half only to see it extended necessitating further override. For example, South Carolina overrode part of P.L. 96-161 in 1980 only to have that law replaced by the Deregulation Act, part of which it has also overridden. Act No. 326 of 1980, Act No. 6 of 1981 To require State legislatures to act to reinstate consumer protections that have been carefully drafted and tailored to meet the desires and needs of the people of a particular State is an unnecessary and unwarranted burden on the States Even though a State may override the preemption (although only in a limited way), there would be a period of preemption nonetheless because the effective date of S.1406 is the date of enactment State legislatures meet for a limited time and chances are most would be out of session on the effective date if S.1406 became law. If a State legislature were in session, it would take time to draft and pass appropriate legislation resulting in a period of chaos during which creditors and consumers alike would not know what law governs consumer credit transactions in their own State.

CONSUMER CREDIT IN SOUTH CAROLINA

The State of South Carolina provides a good example of the results in both a regulated and unregulated credit market. In 1979, prior to the Deregulation Act, South Carolina removed rate ceilings on most first mortgage loans, including home acquisition loans S.C Act No. 7 of 1979. Available statistics show housing starts and mortgage volume decreasing between 1979 and 1980. See S.C. State Housing Authority statistics on mortgage volume of February 25, 1981 and U S. Department of Commerce, Bureau of the Census statistics on housing units authorized in South Carolina for calendar years 1969 to 1980. The volume of business of lenders licensed under the South Carolina Consumer Protection Code (UCCC), on the other hand, has increased annually from 1977 through 1980, the last full year available for statistics. Gross receivable were $477,481,494.18 in 19 $600 702 523.31 in 1978, $706,738,538.07 in 1979, and $790,374,553.28 in 1980. See Annual Report of Supervised Licensees, Consumer Finance Division of Board of Financial Institutions for years 1977, 1978, 1979, and 1980. The number of supervised lenders has also increased annually. In 1977 there were 376 licensees, 413 in 1978, 437 in 1979, and 439 in 1980 Delinquency has not increased over the years but has been reduced from a high of 3.29% contractually delinquent for 60 days in 1978 to 1.09% in 1980, which may reflect the increasing attention creditors are paying to creditworthiness factors in these difficult economic times. The annual reports demonstrate that in South Carolina, a UCCC State with rate ceilings and other restrictions on consumer credit transactions, consumer credit has not dried up. But financing of home acquisition has declined notwithstanding the removal of rate ceilings. Obviously, the removal of rate ceilings is not the answer to our country's economic doldrums. At some point, consumers are unwilling or unable to pay higher rates and will cease to finance transactions whether they are to buy homes, cars, or other consumer goods and services.

S.963

For the reasons outlined in Resolution 1-81, copy attached, the Conference also opposes S 963 which would preempt State finance charge ceilings on consumer credit transactions

SUMMARY

The actual effects of S 1406 or S 963 on the UCCC would ultimately have to be determined by the Federal Reserve Board which has been given interpretive authority under S 1406 and the Courts if either bill became law. Whatever the interpretation, most of the consumer protections now contained in the UCCC would be destroyed. The arguments for S 1406 and other similar federal legislation come from creditors who wish to charge finance charges higher than some States permit. Not only are such arguments unconvincing based on actual experience in States such as South Carolina, S 1406 goes much farther than preempting ceilings on finance charge rates and would destroy the delicate balance between the relatively generous maximum rates and charges now allowed on consumer credit transactions in UCCC States and the consumer protections that go with them. The interrelationship between charges and consumer protections is such that tampering by federal legislation will prevent a State from regulating consumer credit extended by its own creditors to its own consumers. This is an area that has traditionally been left to the States and should remain the province of the States. See Truth in Lending Act §111(b). States' rights and ability to legislate concerning consumer credit in particular and consumer protection in general should not and need not be encroached upon by the federal government. States such as those which have enacted the UCCC have demonstrated their ability to enact balanced, reasonable laws which are flexible and responsive to the needs of all their citizens, consumers and creditors alike. States are continuing to respond to the changing economic environment by amending credit laws after careful consideration of the need for change. Left to regulate this area, more and more States will enact the UCCC or similar modern consumer credit legislation. Federal preemption of the UCCC would be disastrous for consumers and would not be the quick fix for creditors that some may believe. Because passage of S 1406 would result in an unregulated consumer credit market leaving consumers with no protection from overreaching by certain creditors and is an infringement of States' rights, the Conference respectfully opposes it.

KGS/seb

Attachment: Resolution 1-[illegible]

AMERICAN CONFERENCE OF UNIFORM CONSUMER CREDIT CODE STATES
"To achieve cooperation among UCCC Administrators"
ACUCCCS - Founded 1972

R E S O L U T I O N

WHEREAS, Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (Public Law 96-221 as amended) preempts State laws limiting rates and charges on certain consumer credit transactions including the Uniform Consumer Credit Code; and

WHEREAS, the American Conference of Uniform Consumer Credit Code States resolved on May 19, 1980 in Resolution 1-80 that it reaffirms its support of the Uniform Consumer Credit Code as adopted by the various States, including its provisions on rates and charges and limitations on agreements and practices, as the proper approach to assuring an adequate supply of consumer credit and specifically declares that Federal legislation in this area is undesirable, unnecessary and has, in many cases, resulted in the preemption of State laws more responsive to the needs of the citizens of the individual States, and

WHEREAS, the American Conference of Uniform Consumer Credit Code States also urged in Resolution 1-80 that the United States Congress undertake no further preemption of State laws with respect to consumer credit rates, charges or practices so as to allow the individual States an opportunity to study and enact needed reforms in their consumer credit statutes; and

WHEREAS, The American Conference of Uniform Credit Code States also resolved in Resolution 1-80 that it urge the individual states to promptly review their States' statutes preempted by P.L. 96-221 and seek to override the preemptive effects where it was determined to be desirable to demonstrate to the Congress that future preemption of State Consumer Credit Laws is unnecessary in that the States are capable of, and in favor of, regulatory reform to respond to changing conditions of the consumer credit field, and

WHEREAS, Representative LaFalce introduced H.R. 2501 on March 12, 1981 which was referred to the House Committee on Banking, Finance and Urban Affairs and which would, among other things, preempt State laws including the Uniform Consumer Credit Code "expressly limiting the nature, rate, amount of, or manner in which interest, finance charges or other charges or fee [sic]" which may be charged; and

WHEREAS, H R. 2501 would not only preempt all maximum finance charge rates in the Uniform Consumer Credit Code but could be interpreted to preempt all limitations on other charges and fees including late charges, default charges, attorney's fees, deferral fees, and additional charges including insurance charges, closing costs, official fees, and fees for open-end credit plans, as well as restrictions on methods of rebate of unearned finance charges; and

WHEREAS, the majority of Code States have already overridden Title V of P.L. 96-221 as amended or have at least introduced legislation to do so along with other States that are not members of the Conference; and

WHEREAS, the majority of Code States as well as many other States have amended their credit laws to update them in response to the current economic conditions with particular attention to real estate transactions, demonstrating the States' ability to act when necessary.

NOW, THEREFORE, BE IT RESOLVED by the American Conference of Uniform Consumer Credit Code States that the Conference once again reaffirms its support of the Uniform Consumer Credit Code as adopted by the various States, and

BE IT FURTHER RESOLVED that the American Conference of Uniform Consumer Credit Code States urges the United States Congress to reject H.R. 2501 and any other similar legislation that would preempt any part of the Uniform Consumer Credit Code; and

BE IT FURTHER RESOLVED that a copy of this resolution shall be sent to the Congressional delegation of each Code State, to members of the legislature of each Code State, and to the President of the National Association of Consumer Credit Administrators.

1-81
May 23, 1981
San Francisco, California

KS:lgd

Senator LUGAR. Thank you very much, Ms. Smith.

May I ask you, because you noted in your testimony, and I quote: "Left to regulate this area, more States would enact the UCCC." But is it not a fact that only 11 States have enacted all or part of the UCCC in the past 13 years, and what leads you to believe that more States are likely to embrace the UCCC in the next few years? How could we hope to get some kind of a broader comprehensive through that route?

ADDITIONAL STATES INTERESTED IN UCCC

Ms. SMITH. First, you are exactly right. It is 11 States that now have basically the UCCC. There are other States that have provisions from the UCCC, and it was the basis for some Federal regulations that we had as well.

We think that other States would be interested because we have gotten inquiries from other States. We know, at least right now, Minnesota has a bill that would enact the UCCC in that State. But over the last year and a half when we have had what seems to us like a steamroller of Federal preemption, the States are naturally reluctant to do something this comprehensive only with the thought that they may find all of their work undone by a sweeping Federal preemption such as S. 1406.

We believe that left alone, they would do—like many of them have done in the housing area over the last few months—and that is, modernize, upgrade their laws.

Senator LUGAR. I think you make a good point that, given the number of Federal preemptions, that States might be reluctant to move comprehensively, wondering when another law like S. 1406 or whatever else we are talking about today might strike. But at the same time, how do you help the committee with the commonsense problem that I would raise with both you and Representative Begin, that with interest rates on deposits being phased out under Federal mandate—however we came to that point on the liability side but it appears that the asset side is still restrained in a complicated fashion. Not by the Federal Government, but by the States.

We have noted, and you have, that mortgage rates have been preempted by the Federal Government and agricultural and business loans. We are finally down now to talking about consumer loans, essentially. You make a point—and I think many have, and all of you have in your way eloquently—that federalism implies active and vigorous State governments—executives, legislatures, and what have you.

I suppose logically you could say—granted, all of the premises of my question—maybe all of these things should not have occurred. Maybe we would be better off in fact if at the State level we were still regulating antitrust rates and assets and liabilities. But we are not.

So given that texture, why do you feel that States' rights ought to be asserted so strongly in this consumer area that remains, given the texture of all of the rest of the assets and liabilities that I have described? Would you comment on that, and then Representative Begin?

[illegible] the other legisl[illegible] [illegible] we have [illegible]

[illegible] I cannot stress [illegible] demonstrated that they [illegible] the issues in respon[illegible] [illegible] I think the States [illegible] [illegible] nuances, the unique ch[illegible] [illegible] legislation that is suitable [illegible] [illegible] be done on a Feder[illegible]

[illegible] RATE CEILINGS

[illegible] California is extremel[illegible] [illegible] your testimony suggests [illegible] credit interest rate restric[illegible] [illegible] under your legislation and [illegible] [illegible] why are you endorsing S[illegible] [illegible] occurring in the other [illegible]

[illegible] problem. We have, in [illegible] we had a $2[illegible] million [illegible] suggested perhaps that we [illegible] immediately surrender. [illegible] Republican colleagues said that with [illegible] forces we would win [illegible] what would we do with the rest of the country?"

[illegible] whole situation [illegible] State boundaries. Frankly, from [illegible] States, indeed if they [illegible] a mode set by

the people. the people in 1979 voted to deregulate—by a vote of the people, to vote for higher interest rates. We deregulated through a vote of the people and I think the legislature would follow suit. And if we have deregulated rates as far as the cost of money in California, I think it will put us at a competitive advantage, and certainly other States at a disadvantage. I come forward today recognizing it is a national problem, one that even though I am confident California will deal with it, I think that it is one that should be dealt with again from border to border.

Senator LUGAR. Let me ask from the experience of each of you, how you would comment on the testimony we received the other day from a representative of VISA credit card regarding their situation. My understanding from his testimony is that there were as many as 64,500,000 VISA cards presently in circulation. I have no idea how many other credit cards are in circulation, but that was an impressive figure.

The point that he made in his testimony was that regardless of the usury law that the State may have in the State in which you are located, if you happen to have one of these cards in hand and it is honored by a merchant or a restaurant or what have you, you can use it. And therefore, the only limits that apply are the ones that are being applied essentially by VISA.

If, in fact, credit is now flowing in this sort of a way, in direct answer to questions of the committee, he indicated that if, in fact, one State of the Union had deregulated credit, VISA could locate there and in essence, the 64,500,000 are liberated of all usury statutes. Given this kind of a situation, how relevant are State usury ceilings?

Maybe from the experience as you pointed out, each State is very different in terms of its pattern, the nature of its commerce. But given the flow in that sort of a way, really what are we dealing with here. Would you make a comment, please?

Ms. SMITH. I would be happy to. It is a very good point that you make, and, of course, we are concerned with the effect of national banks being able to export their rates. However, we feel like in South Carolina, where we regulate in-State banks, that if we have—and we can provide competition in our State, and let me point out here, we have a 24-percent ceiling on all revolving credit whether it is by bank or a furniture store. It is all the same. But we have competition in South Carolina that brings the rate down.

I don't know of anyone who is charging the maximum of 24 percent on a VISA card in South Carolina. So what we see is a question of consumer education. You educate consumers that yes, this bank located in, let's say, New York, might be able to charge you 40 percent because there is no ceiling up in New York, but look in your own backyard. You have banks here that are competing with one another that are charging no more than 18 percent annual percentage rate, and there are various fees and charges that go along with that. Competition is working to bring those rates down right now.

I see it as a matter of letting the consumer know what is available and letting him choose which bank's VISA card he would like to use.

Mr. BEGIN. Free enterprise in the open marketplace does not only exist in the commercial sector, but does, I think—is active and applies among States, between States. And that is healthy. If a State wants to enact unrealistically low usury laws, then that is their prerogative. They may be subject to losing a financial institution or a credit card company that would locate there to a State whose usury statutes are perhaps a little more liberal. But I think that with free enterprise, it will reach a market level but they will tend to flow to those States where it is more liberal. And that will be an incentive for the States to modernize their laws. And I think that that has shown true in other areas.

I know that in legislation—many pieces of legislation that we consider, and because in a small State like Rhode Island we do not live in a vacuum and you can throw a stone into Massachusetts or Connecticut from where I live, we have to be very sensitive to what the other States do. And I think all States feel that way, so there is that natural competition that would force us to upgrade our laws and I think that would be just a very natural thing for us to do.

SPREAD AND USAGE OF CREDIT CARDS

Mr. YOUNG. As I testified, I think one point that became abundantly clear for us in California, the spread and usage of credit cards represents again an added cost to the consumer in the sense that the merchant has to pay for that use in one way or the other. Second, it also in our State, where there is not a ceiling on that, by forcing people to do that, they, in a way, circumvent whatever usury laws exist. And I think that is going to be, again, more widespread phenomenon that will happen throughout this country.

Most of all, again, the people who cannot get the VISA cards who go into a card dealer, who go into a furniture store to buy a refrigerator they must have, typically the people on the lower end, the moderate income people to lower income people cannot qualify for a VISA card and thus are forced to go into the credit marketplace elsewhere, and oftentimes unregulated marketplaces where they have to pay again far higher interest rates. And tragically, as we found in California, have to put up every worldly good as a collateral. So I really think that the phenomena of credit cards presents some dangers that can only be corrected by allowing the availability of credit for everyone based upon the true cost of money and their ability to pay.

Senator LUGAR. You have made an important distinction here which is a point of departure, I guess, in this questioning; that not everybody qualifies for a credit card. And, of course, some people do not want to use credit cards. But then many people would like to use them but do not qualify, as you pointed out.

So then we come back to the fact that there is real application of usury laws to stores, merchants, furniture, automobile dealers, or what have you, who are very much a part of the State. They are not in interstate commerce at all. What one witness pointed out the other day in the colloquy was that one of the effects of usury ceilings in some States is to leave to the captive finance companies for automobile dealers to make some subsidies with regard to States where there are usury limits, and thus expedite sale of cars there; and perhaps to shift the burden of the expense to States

where there are no limits. Now, one could argue that in State strategy, if you were clever enough, therefore, to have very low usury ceilings, you could, in effect, push the incidence of that type of shift of expense to some other State that the finance company would be subsidizing your people and not someone else.

But on the other hand, there appear to be distortions in this type of thing. In other words, we found that automobile finance has now flowed away from local banks or local credit situations to the national concerns, and that shift has been rather marked over a course of time. At least, some felt that one of the reasons was the distortions created by State usury laws. Do any of you have comments on that situation?

We have an important problem with automobiles and with furniture. There may be other items that come into this, but those few certainly have been foremost in many people's testimony.

Mr. YOUNG. We in California have come to recognize that money is a commodity. It has an intendent cost with it. It is foolish and unrealistic to think that any retailer or any person granting credit can borrow money at 21 or 22 or 23 percent, and then loan it at 18 percent and observe that themselves, without in some way passing it on to the consumer. And again, that notion is incredibly outdated and it ignores reality.

I think it is time, certainly in California, that we recognize that; that there is a cost of it one way or another and the consumer is going to pay for it. We in Government cannot sit back and mandate that the creditor, those granting credit, in some way absorb this. In essence, I guess there are no free lunches. That is a cost of goods that must be passed on to the consumers. We think it should be passed on directly and openly and disclosed, not through higher prices in other States. Not through some other fashion or some other manner. It should be done directly so that the consumer knows precisely what they are paying for. Indeed, money costs money and we should stop artificially trying to restrict its value below what its true worth is.

Mr. BEGIN. I have no specific comment with regard to your statement. I can say that in my experience in my State, we have not experienced that kind of a situation. I can just make a comment about what the Senator from California says. I wholeheartedly agree that that kind of a situation is something maybe the California legislature should deal with. The California legislature, and not Washington.

Senator LUGAR. Ms. Smith?

Ms. SMITH. Yes. I will make one brief comment here, although I am not aware of any dislocation, as you speak of, in South Carolina. As far as I know, we are financing cars, furniture, everything locally.

I would just like to say from the extremes between Arkansas with its 10 percent ceiling and California perhaps with no ceiling, we are not saying that one State or the other is right or wrong. I suppose we are somewhere in the middle. We just think it is something that the States can respond to themselves and that they will.

DEREGULATION OF INTEREST LED TO DILEMMA

Senator LUGAR. Let me ask one final question. Clearly the deregulation of the deposit side of how much interest units can pay has led to a dilemma of sorts, because savings and loans, credit unions and others are, of course, attempting to pay a competitive rate of interest to gain deposits, and they also, of course, are trying to charge enough on their loans to pull themselves up by their bootstraps. Now, one could say, I suppose, and this would be comforting to this committee, that whether savings and loans fail by the tens or the hundreds is a local problem, a State problem; or that credit unions—it should be handled by the State legislatures.

By and large, most people are not saying that. They are saying, as a matter of fact, we have a national dilemma here. And to the extent that by congressional activities and the ongoing regulation that we have forced people into more and more of a bind and failed to give them relief on the asset side. We are perpetuating that problem that finally comes to haunt all of us and finds its place for resolution at the Federal level.

What do any of you have to say with regard to that dilemma? It is a form and variation of the first question; that is, how do you deregulate the asset side and not the liability? But at the same time, it tries to address a little bit as to why this is a state or federal problem, and we are wrestling with that, obviously, in this whole concept of S. 1406.

Mr. BEGIN. It is a good question, Senator. I think, as you have pointed out, the thrift industry is facing some very severe times now. The losses are incredible. All of us are quite aware of that. I would wonder, I would question, was Congress thinking about that? Would they have the foresight to consider that when they deregulated the liability side of the balance sheet?

There is a concern about the asset side being stuck with a low-yielding portfolio for mortgages or whatever, and it is something that Congress, I would assume, I would hope, did give some consideration. It almost sounds as though the logic is that Congress feels because they took the initiative in the first place to deregulate the liability side, and one may question the prudence of that, but that justifies the continued preemption or entry into the regulating of the financial institution industry.

Perhaps it might be worth considering as a savior for the thrift industry to review the phaseout period and perhaps extend it a few more years. I know that would be very controversial, but there may be solutions that can be reached with the legislation that was passed last year to deal with the problem, without using that first action as a means of justifying the continued preemption with interference by the Federal Government in the dual banking system.

Senator LUGAR. That is an important comment. I suppose the dilemma, having sat through a number of these dilemmas, is that many people who have been saving for a while, wanted more money, of interest on their savings—there was a rather strong feeling, and as a matter of fact it was expressed by people going into the money market funds and various other avenues totally outside of what we have been talking about. Whatever the Congress might have designed, I am not sure you can put the genie

back in the bottle again. There is a desire on the part of people who are saving in the country to get a fair return on their money.

If we started up from zero again, convinced savers that they ought to be satisfied with 5¼——

Mr. BEGIN. I am as concerned as you are about the consumers. But who was it that began the regulation of the financial industry to begin with? It was the government that began to regulate the financial institution industry, and certainly they should be as considerate about the saving of those thrift industries, the different types of industries, so that they do survive during this deregulatory process.

Senator LUGAR. That is a good point. It is long history as to how it all started, and I suppose it preceded our legislative lives. Maybe our physical lives.

Mr. YOUNG. I just want to say in regard to that point, that the step that was taken by Congress as far as the deregulation process one-sided the balance sheet, really it brought us into reality. It ignored the world facts and it ignored again what was happening from an economic standpoint, not just in America but in the world. And I think again we are always—we want to argue situational ethics and come forth and rail for States' rights, until it is appropriate and convenient for us to have the Federal preemption.

And I think again in this regard, we have started the process in a process that again recognizes what happens in the world to not finish it by going ahead with S. 1406. Literally it leaves us in the middle of some kind of a quandary, and I think that the direction must be forward with a recognition of worldwide monetary flow of money.

And again, I want to conclude by stressing I consider that money is a commodity that flows through from State to State, and indeed, constitutionally, it is an obligation and responsibility of this Congress to regulate and to govern the flow of that, and for that certainly I think that is, if nothing else, a sound thesis for trying to deregulate retail credit.

Senator LUGAR. Ms. Smith, do you have a final word?

Ms. SMITH. Yes, please. I can appreciate your dilemma. On the other hand, I am not aware of our institutions failing in South Carolina. Now, we are not closing our eyes and just saying we will stick with what law we have. We are always looking at ways to improve it. That is one of the goals of the UCCC. But we do not see why what we believe is a good law, like ours, why it should be dragged down because of some problems that may be occurring far from us.

I would like to close, if we are closing now, with the final point that what we are talking about here in S. 1406 I think is that it is intended to do one thing, but that it has some unforeseen effects. We are very, very concerned with that, even though we are talking about rates here and rate ceilings. S. 1406 covers everything, rate ceilings and preempting those, I think, is bad enough. But to go the further step and preempt everything that goes along with it just destroys a very carefully written law like the UCCC.

Senator LUGAR. Thank you very much. We appreciate all three of you coming. You make up a very stimulating panel and we are

grateful for your moving right along with the dialog, thinking along with us.

This concludes our third day of hearing on S. 1406 and S. 963. The hearing is recessed.

[Whereupon, at 12:16 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

STATEMENT

OF

G. ALAN STEUBER, PRESIDENT,

PRULEASE, INC.

A SUBSIDIARY OF

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

As President of PruLease, Inc., I am pleased to have the opportunity to submit to this Subcommittee our position strongly supporting S. 1406, the proposed amendment to the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221) which would deregulate interest rate ceilings on business and agricultural loans. PruLease, Inc. is a subsidiary of The Prudential Insurance Company of America and is engaged nation-wide in the business of providing financial services to major utility and industrial corporations under written agreements in the form of secured and unsecured loans as well as leases, leases intended as security, and similar instruments.

The interest factor (or its equivalent) of the required payments under most PruLease agreements fluctuates monthly based upon changes in the prime rate of a specified bank or in the rate for commercial paper issued by PruLease. Such "fluctuating-rate" pricing allows PruLease to recover its cost of funds and thereby to make capital available to our customers despite extreme fluctuations in the money market. Such pricing also assures our customers of paying interest at current rates, regardless of changes in the money market. However, in view of the fact that bank prime rates have recently reached historic highs, PruLease has been forced to discontinue its lending business in that minority of states which do not exempt business loans from usury ceilings or which have usury ceilings which are too low to accomodate current conditions. This has adversely affected the growth of our portfolio and has limited the sources of funds available to prospective customers for capital investment in those states. We understand other financial sources have been similarly

affected and that the result has been an unnecessary limitation on the expansion of business and industry and on the growth and strength of the economy. We believe that business borrowers should be free to negotiate lending arrangements at arms length and in good faith, without arbitrary usury limitations on interest rates.

Congress has recognized the problems created by restrictive state usury ceilings and on three recent occasions has enacted legislation which was intended to be remedial (P.L. 93-501, P.L. 96-221 and P.L. 96-399). However, these measures failed to anticipate the degree of turbulence in the money markets and consequently have proven inadequate to accomplish their objectives. We believe that S. 1406 will go a long way towards providing the necessary relief to the American economy.

TESTIMONY ON BEHALF OF
VERMONT LOW INCOME ADVOCACY COUNCIL
J.D. AND MINNIE TERRY, VICTORIA AND HOWARD MCKINNEY

BY THE NATIONAL CONSUMER LAW CENTER, INC.

I. Introduction.

This statement is written on behalf of J.D. and Minnie Terry, Victoria and Howard McKinney, two low-income couples from Tucson, Arizona, and the Vermont Low Income Advocacy Council an advocacy group of low-income consumers.[1] Mr. and Mrs. Terry are facing mortgage foreclosure proceedings after signing a loan with a balloon payment of over $12,000. The loan, which carried an annual percentage rate of 39.6%, was the fourth refinancing of a loan originally written in 1976. Mr. Terry is blind and he and Mrs. Terry live on Social Security. Mr. and Mrs. McKinney were threatened with foreclosure proceedings on a loan carrying a ballon payment of more than $12,000. That loan was the fourth refinancing. Mr. and Mrs. McKinney had dealt with this particular lender because of his advertisements that he lent at homeowners, not finance company, rates. In fact,the loan annual percentage rate was 26%, a rate much higher than most first or second morgages.

The credit supply[2] problems described to this Subcommittee are very serious ones. Nationally, the automobile industry is in dire straits; in Arkansas, car dealers and retailers are closing their doors. These difficulties are of concern to all of us and a solution, if one exists, should be found. But preemption, the solution proposed here, is not the answer. The two goals of the proposed legislation - expanding credit availability and improving the financial positions of merchants - will not be accomplished by passage of the legislation. Nor is it a fair solution to preempt usury ceilings in 50 states to solve the difficulties of Arkansas retailers.

Preemption will cause great harm to consumers and to the economy. Using conservative calculations, it will cost borrowers over $20 billion in additional finance charges, allow lenders to hide costs in a variety of special fees that make comparison shopping for loans difficult, and will precipitate defaults and bankruptcies. Preemption will be a boon to lenders' profits but may be disasterous for retailers. By a more realistic calculation, it will divert $65 billion from retailers to lenders. This diversion together with consumer defaults and bankruptcies will threaten the financial stability of businesses already suffering from high interest rates on inventory. And high consumer interest rates may cause a slump in the important housing and automobile industries. Preemption also raises troubling questions regarding respect for democratic principles and federal intrusion into an area traditionally regulated by the states.

II. The People of Arkansas Should Not Be Forced to Abandon Their Chosen, Evidently Successful, Course.

The witnesses from Arkansas have testified that Arkansas automobile dealers and other retail businesses have failed as a

result of the current 10% ceiling on interest rates. They allege that they could not make credit sales at high rates nor survive on the diminished volume of cash-only sales. We do not want to deny the tragedy of these events though we dispute the cause. Automobile dealers and retailers are closing their doors all over the country, even in states such as Arizona which have been without ceilings for some time now. Many cannot survive when the interest rates on their inventory are as high as they have been for the last two years.

The important question is whether the cause lies in low usury ceilings or elsewhere. The general state of the Arkansas economy is relevant to this question. Arkansas' economy as a whole is sound. Arkansas, which is still largely an agricultural state, has been gaining on the U.S. in personal income on a per capita basis. As a percentage of the U.S. per capital personal income, the Arkansas per capita personal income increased from 62% in 1958 to 78% in 1979.[3] During that same time period, Arkansas non-agricultural employment increased 104% compared to 46% for the U.S.[4] This suggests that the low usury ceiling is not causing business to fail.

So the Arkansas economy is doing well, and in part because of, not despite, the low ceiling. Less credit has enabled Arkansas to recover more quickly from a recession. Arkansas has not had the drain of expendable income due to very high interest rates as other states have had. As a result Arkansas has suffered less during recessions which follow high interest rates and has bounced back more readily.[5]

There is another reason for not overturning Arkansas law--respect for democratic principles. The Arkansas people appear to like their economy as it is. They have said, by their recent vote, and by earlier votes, that they do not want their state's economy and the demand for consumer goods to be artifically inflated, as it has been, by the easy availability of credit. While one may not personally hold to this value, tolerance and encouragement of diversity in values has always been a strength of Americans. And while one may quarrel with the decision that a less volatile, more liquid economy is better for the people of Arkansas, one cannot quarrel with the notion that the people of Arkansas are best able to make that decision for themselves.

This same kind of decision has been made by other states. For example, a few years ago the Maine legislative enacted a law, referred to as the "36-month rule", which limited loan maturity by restricting interest charges to 8 percent APR on all loans (including extensions and refinancings) outstanding 36 months from the initial loan. Since much of the profit for loan companies is in refinancing and the Maine law removed the profit from refinancing, many finance companies left the state and people who had borrowed from finance companies switched to banks or credit unions or stopped borrowing. A study of those who were unable to obtain credit showed that 55% felt "better

off" at not being able to borrow.[6] Presumably they felt better at being free of debt and able to spend their earnings on housing, ford and other pruchases than or repaying borrowed money.

III. Federal Preemption is Not Necessary for the Continued Adequate Supply of Credit.

Not only is it unfair to the people of Arkansas to deprive them of the results of their democrative process, it is irrational to force the rest of the nation's consumers to pay higher interest rates to solve the problems of retailers in Arkansas. Proponents of preemption respond that the problem is nationwide but they have not made this case on this point.

The argument by proponents of preemption that the rate ceiling problem is nationwide rests on the example of the auto industry. It appears that the American automobile industry is in difficulty for four reasons - inability to compete with foreign cars; inflation resulting in high prices; high interest rates resulting in credit prices too high for those wanting to buy American cars; denial of credit to potential buyers who fail to qualify when interest rates are high. Witnesses testifying before this Subcommittee in July and before the full committee in April and May ignore the factor that lack of competitiveness with imported cars plays. This is a very important factor. Foreign automobile manufactures and dealers are thriving. Imported cars increased their market share from 22% in 1979 to 27% in 1980 and to 29% in the first two months of 1981[7]. The Value Line Investment Survey's analysis of the auto industry notes:

> [M]any car buyers think of the imports as more reliable, better made, and better values, especially when the buyers are thinking in terms of small, fuel-efficient cars.[8]

That is why sales of American cars have dropped. Buyers prefer imported cars. The problem is not credit availabilty. Foreign cars cost more than American cars yet they are being financed in record numbers. Note that the foreign automobile dealers association, is not before this subcommittee in need of help.

Inflation also plays an important role by increasing the price of cars so some potential buyers no longer want to buy and some of those who do want to buy can no longer afford the price. Allowing lenders to charge higher finance charges will merely drive up the total price and further decrease sales.

Both consumers and automobile dealers and automobile finance companies recognize that higher interest rates further contribute to the loss of sales. There is disagreement, however, over the way in which high rates decrease sales and thus there is disagreement over the solution. Automobile dealers want the members of this Subcommittee to believe that

high market interest rates coupled with lower consumer interest ceilings make credit unavailable and that this is why sales are lost. They insist that a significant cause of low sales is not competition or inflation but the unavailability of credit. This is not the explanation given by those knowledgeable about car financing. The Value Line Investment Survey notes that demand for cars is low because consumers have little money to spend[9]. The Survey notes that most new car buyers require debt to purchase a high ticket item and currently the average consumer has about as much debt as he can handle[10]

Another cause of low sales is high interest rates. General Motors Acceptance Corporation President Robert Murphy drew a connection between high interest rates, not credit availability, and low sales and predicted that sales would improve when interest rates came down.[11]

Auto dealers have not proven their claim - that people are unable to get credit - or the supposed cause- the unavailability of credit. Consumer credit increased in 1980 over 1979. December, 1979, total consumer installment credit was $312,024 million[12] and in December, 1980, the total was $313,435. Automobile credit increased from $115,022 million in December, 1979 to $116,327 million in December, 1980.

While the growth from 1980 to 1981 was not as great as in earlier years, several facts suggest this slack is due not to the unwillingness of lenders to lend but to the unwillingness of consumers to borrow. First, Chairman of the National Credit Union Administrative Board, stated that 1980 demand for loans was low.[13]

Second, analysts noted that retail sales dropped sharply when credit controls were announced in the spring of 1980. Credit controls were reported to have a tremendous psychological effect on consumers; many stopped shopping altogether or stopped using credit cards.[14]

Third, Wendell Miller, President of the National Automobile Dealers Association noted a similar trend. When he testified before this subcommittee on July 9 he stated that consumers stop borrowing when the prime increases even though the rate at which finance companies lend and thus the cost to consumers does not increase.

Fourth, outstanding open-end credit has declined. Two facts suggest this decline is due to consumer restraint rather than creditor restraint. Credit cardholders have and have had billions of dollars of unused lines of credit but are not using them. Since the cards issuers have little control over the amount charged on the cards, the decline must be due to voluntary reduction in use by consumers. In addition, an estimated 9% of credit cardholders cut up and returned their cards to issuers in 1980. This reduction came at a time when card issuers began imposing annual or transaction fees and

since such fees sharply increased the costs of credit, the reduction in use may well be due to the refusal of cardholders to pay access fees. The fact that so many consumers could tear up cards suggest too much credit was available or credit costs were too high. In either case, preemption will not help.

Finally, no one appears to be complaining about not being able to obtain credit. Neither the major newspapers nor the consumer credit publications are reporting a lack of supply of credit. Rather, it appears as if consumers are deciding they do not want or cannot afford credit at existing high rates.

So credit appears to be generally available. Of course even then some people may not be able to get financing, and dealers claim this small percentage means the difference between profits and bankruptcy. Dealers claim that 30% of applicants are turned down. The most important question to ask about this claim is whether is the normal rejection rate is ever higher. In the past, two major consumer finance companies have reported turndown rates of 58.3 and 57.2%.[15] 30% is very low in comparison! Second, why are these people turned down? It may be because, as the Value Line Investment Survey found, consumers have as much debt as they can carry. It is also possible that the already high interest rate increases the monthly payments so the buyer cannot afford the loan. There may also exist other causes having nothing to do with rate ceilings. The sales price on the used car may be too high, or the downpayment too low, making the loan risky. Only if the applicants are turned down by lenders unwilling to lend because profits are too low is preemption even a remotely feasible solution. Supposing that is the case, if interest rates are raised will the applicants currently eligible for credit be eligible at higher interest rates? Raising the rate on a $3500 used car from 16% to 31% as was done in Arizona increases the monthly payments (on the 12 month financing available in Arizona) from $310.70 to $342.92. A person earning $15,000 and who is allowed by the lender to carry 25% of his gross income in debt can carry a payment of $310 but not one of $342.

<u>Automotive News</u> recognizes the effect of higher payments on the eligibility for credit. "Not only high sticker prices but with the high cost of paper, their payments are just plain too large," it states.[16]

If interest rates increase, cars sales may suffer just as mobile home sales have suffered. Mobile home purhcases were down by 20% in 1980.[17] Rates on the other hand were up substantially, the 1980 range being 15.98% to 14.05% and the 1979 rate range being 13.465 to 13.83%.[18] The 1980 federal preemption of mobile home ceilings and resulting higher rates should have guaranteed an adequate supply of credit so availability seems not to have caused the slump in sales.

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IV. <u>Retailers Are Not Entitled to Help Merely Because the Housing Industry Received Assistance</u>

Auto dealers implicitly argue that since Congress preempted interest ceilings on loans for homes it should preempt them for users of autos also. This does not make sense since there are differences between the used car market and the housing market which call for different solutions.[7] The used car industry is not suffering from low interest rate ceilings as the housing market was. The typical first mortgage ceiling prior to preemption was 11 or 12%. The average used car financing ceiling where it exists, is roughly twice as high, 23.63% See *Appendix B*,. Several states have no ceiling and in those states the rates could go much higher. Second, there is more competition in the housing market and so ceilings as a means of keeping rates reasonable is not as crucial. There is more competition because mortgage credit is not usually "tied" to a product. The house buyer shops extensively for mortgage credit. In contrast, the used car buyer frequently can obtain credit only from the used car dealer. For this reason, he is less likely to question the price of the credit or to turn it down as too expensive.

Third, supposing the proponents of preemption were correct and the used car credit market was competitive, removing the interest ceilings may not help. Rates would still go up and buyers would stop buying. This point was made earlier by Wendell Miller of NADA who said in his testimony before this subcommittee that people stop buying when rates go up. This has also been true of the mobile home industry. Mobile home sales were down 20% in 1980 in part because of high interest rates. And it is somewhat true of housing. Sales plummet when the banks ask more than 16%. It is true that borrowers are adjusting to higher rates on mortgages, but they may not make that same adjustment on cars. This is because a house is a good investment and may make the cost worthwhile. Housing has risen in price 20% each of the past 5 years. Cars, on the other hand, decline in value. The car with the best resale value, the Honda, declines by 4%, in the first year, more after that. Other cars decline more rapidly.

The American auto industry may be sounding its death knell by raising the price of sales finance. The problem of the auto industry is a terrible one, but this solution may be deadly.

V. <u>Federal Preemption is Inappropriate Because States Can and do Raise Rates in Respond to Increases in The Cost of Funds.</u>

Not only is the current supply of credit adequate, significant rate relief by nearly every state legislature over the last two years has taken place and should ensure the continued adequate supply of credit. Subcommittee members should be familiar with

the details of this state relief before concluding that state action has been inadequate.

There have been many, many changes in the rate ceilings of the 50 states over the last two years. Six states (New York, New Jersey, Delaware, Arizona, Montana and South Dakota) have removed usury ceilings for all types of consumer lending (There are criminal usury statutes of 30% and 25% respectively in New York and New Jersey). New Mexico, with a criminal usury ceiling of 45%, has eliminated ceilings for most loans. 11 states (Alabama, Illinois, Michigan, Mississippi, Missouri, New Hampshire, North Dakota, Pennsylvania Tenessee and Wisconsin) have floating rate ceilings tied to the Federal Reserve discount rate, U.S. notes or bonds, or time deposits. As the base rate rises, the rate lenders can charge also rises. In addition, the UCCC states of Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah and Wyoming have an inflation provision which allows the UCCC administrator to increase the break points by 10% whenever the price index increases by 10%. This inflation provision has given creditors many rate increases without statutory change.

The remaining 22 states and the District of Columbia have raised interest rates in the last year, some of them significantly. Only Arkansas has failed to provide rate relief.

While not every consumer rate statute in every state was amended, many rates were already high and some states already lacked ceilings on certain types of loans. For example, Massachusetts has no ceiling for closed-end loans by banks. Tennessee has no ceiling on automobile loans. Many states follow the time price doctrine which allows a merchant to have two prices, a "cash" price and a "time sale" price. Court decisions hold and some statutes say that the time price difference is not interest and legal limits on interest do not apply. In these states the retailer can charge whatever he wants for goods sold on credit. Kentucky, North Carolina, Oregan, and Minnesota have no ceiling on sales finance of goods other than autos.

As a practical matter it seems bad policy to remove the ceilings. More limited adjustments are all that is needed. The many changes described above have occurred because legislators are making fine adjustments to reflect the market conditions within their states, the degree of competition within various classes of lending (auto finance, other goods finance, loans, open-end, second mortgage, secured and unsecured), between various types of lenders, and between various types of borrowers (poorer, less well educated people locked into borrowing in their competition-free neighborhood or wealthier, well educated borrowers with numerous credit options). There is no uniform solution within a state or among states to rate problems because market conditions fluctuate widely. The beauty of state regulation is the freedom to innovate. The solution to the high cost of borrowing is not

obvious. It may be deregulation, it may be deregulation for certain types of credit or classes of creditors, it may be higher ceilings, or it may be low ceilings as in Arkansas. Various states have adopted different responses and time will tell whether a particular approach works. It may be that more than one approach provides adequate income to lenders and at the same time protects consumers. Conversely, it may be that there is no one approach that works well in every state. If ceilings are preempted we will know only that preemption works or does not work; we will never know if other valid proposals would have been more successful.

Some witnesses before this subcommittee have argued that the rates change so quickly that the state ceilings in some of those states are already outdated. But state legislators know how long it takes to pass legislation in their respective states. They know the lag time on legislation and presumably have set a rate which compensates lenders for that lag.

Preemption is also an insult to the states. It derives from a view that state legislators have not found the correct answer to the inflation-caused high cost of borrowing and that they will never find it. Given the many years of states control of rates and the serious and conscientious approach of the states, that view is unwarranted. Credit rate regulation has been the matter of the several states for two centuries. Congress should not destroy this arrangement without seriously studying the need and consequence.

VI. <u>The Cost of Borrowed Funds is Not as High as Prime</u>

One has so often heard the claim "the prime is 19% and the ceiling on consumer lending is 18% and so we are making no money" one begins to believe it. A careful analysis shows the invalidity of the claim. This claim implies that lenders pay the prime rate for their funds and that 18% is the highest rate allowed under state ceilings. Neither fact is true. Most lenders do not pay prime on their borrowed funds. For example, in 1980 when the prime ranged from 11% to 21.5% the average cost of borrowed funds to savings and loans was 9.11%.[20] For Federal credit unions, share accounts paying up to 7% comprised 71.9% of savings.[21] Even if all 71.9% of the savings were paying 7% which is highly unlikely and the credit unions were paying 19% on their other funds, their average cost of funds would be 6.5%, one-third of prime. VISA members were paying 10.8% for their funds in 1980.[22] The Massachusetts small loan board based its 1980 rate order on the assumption that finance companies would pay between 9 and 10% for borrowed funds from 1981 through 1983.[23]

The claim also implies that the highest ceiling is 18% and less than prime when in fact most states have one or more consumer interest rate ceilings significantly higher than 18% and higher than prime. Appendix B shows the rates that each state could charge on a $2000 loan financed over 2 years. Only 2 states

(Arkansas and Missouri) have rates under 20%. The average rate in the 44 states (and D.C.) with a criminal or other ceiling is 24.33%. 6 states have no ceilings at all.

There are several reasons why lenders do not pay the prime rate for their funds. First, most of the money they borrow comes from commercial paper which is cheaper than money. According to Federal Reserve Statistical Release G.20 (422), on May 31, 1981, more than 78% of the liabilities of finance companies' were in commercial paper, and the percentage appears to be increasing. Commercial paper is much cheaper than bank money. In fact, some of the money borrowed on commercial paper by Massachusetts insurance premium finance companies in 1978-79 was borrowed at 2-3%.

Second, some money borrowed at prime was borrowed under long term obligations when the prime was several points lower than it is now. An economist testifying in the 1980 Massachusetts small loan rate hearings estimated that only 5% of the liabilities of finance companies is in short term notes.[24] Third, consumer finance companies and retailers do not borrow all the money they lend out. Some of it comes from retained earnings. Not only is this cheap money, it saves stockholders tax money. Instead of distributing retained earnings to stockholders in the form of dividends, taxed as ordinaary income, the earnings are kept and the stock increases in value. The stockholders profits are then taxed as capital gain. Fourth, not all of the money they borrow from banks is borrowed at prime. Rep. St. Germaine found that many banks were lending, to big and small business customers, at several points below the announced "prime".

We are not claiming that companies paying 9 or 10% are making a killing. We are saying, the picture is not as simple or as gloomy as preemption proponents describe it.

If companies are paying more than the 9 or 10% paid by credit unions, card issuers, and finance companies, it has got to be because of bad cost management. Congress should not preempt state ceilings merely to save the inefficient companies.

VII. Preemption Will Divert Between $20 and $65 Billion From Retailers and Consumers to Lenders.

The fact that lenders are requesting help suggests times are not easy. But times are extremely difficult for everyone. Due to the necessary federal efforts to fight inflation consumers are going bankrupt too, because they can't meet high interest rate obligations or their profits (salaries) are too low. Consumers are hurt as much by inflation and declining productivity as businesses but the solution proposed here would multiple their troubles.

Every million dollars of relief granted lenders will come out of the pocket of the overburdened retailers and consumers. The estimated costs of preemption vary depending on the estimated increase in interest rates. Preemption is conservatively estimated as costing retailers and consumers $20 billion[25] in added finance charges in the first year alone. This estimate is based on the conservative assumption that existing rates of 18 to 26% will rise by 6-10 points to 24-36%. But rates could go much higher. A review of interest rates in jurisdictions where ceilings have been removed or where existing ceilings are extremely high is instructive on this point. Some New York City furniture dealers are financing sales at rates up to 208.2%.[26] According to the Banking Department, seven of the nine stores were reported as financing at rates between 21.3% and 85.3%.[27] This means the other two were charging at rates of more than 85.3%. Unconscionable rates are also being charged in Arizona. There one creditor charged an annual percentage rate of 51%, three times or 33 points higher than the announced prime rate. $2000 borrowed for three years at 50% will cost $1898.20 in finance charges. Under the old rate it would have cost $788. Other lenders are charging more than 47% APR on loans secured by the equity in the borrower's home. Used car dealers in Arizona are charging 30% APRs on what are considered low-risk loans because they are secured by the cars purchased. Before deregulation, these dealers were charging 18% interest charges. These rates are greatly in excess of what any analyst would consider necessary for an adequate return.

If rates were to double, and there is substantial evidence that they might, the increases will also cost retailers and consumers roughly $65 billion in sales. The calculation is made in this way: A family with $100 a month of disposable income can carry a loan of $3800 repayable in 48 months when the interest rate is 12%. When the rate is 24%, the family can only carry a loan of $3040. This is a net loss of $800 - 21% in purchasing power. If everybody experienced this same loss of purchasing power - and they will if rate ceilings are preempted - the borrowers will lose 21% of their purchasing power. In December, 1980, total consumer installment debt or purchasing power was $313.435 billion. 21% of that is $65.986 billion. This means consumers have $66 billion less to supend for goods. The money is diverted from retailers and consumers to lenders. Increasing interest rates, then, may do the retailers more harm than good.

VIII. <u>There is Insufficient Competition to Keep Market Rates Reasonable.</u>

A. What Little Competition Exists Takes Place in Middle Class Markets on the Basis of Quality and Variety of Merchandise Not on Credit Costs.

Proponents of preemption say that competition will produce market rates, but studiously avoid the fact that competition has not set market rates in the examples above. These free market rates are high for several reasons. First, though, there may be some competition in bank credit cards and in the new car market, there is little competition over rates in the used car, direct consumer loan and retail merchant charge card markets. Retailers, including car dealers, rarely advertise interest charges. Instead they advertise their prices and the variety and quality of their merchandise. Finance companies do not advertise their business but rely on location and purchasing of contracts to get business. In the rare cases where credit is advertised, it is marketed on the basis of convenience or easy availability rather than price. The used car advertisements from Arizona, attached hereto as Exhibit C, are a good example of this.

Competition is meaningless when people are locked into certain agreements and cannot take advantage of the competition. For example, a credit card holder paying 25% on his credit card balance may learn that a different issuer is charging only 22%. He cannot take advantage of this, however, if the bank is taking applications only from existing depositors or the applicant does not make enough money to qulaify for credit from that card issuer. He may have recently paid an annual fee which is wasted if he switches card issuers. Even if he manages to get another card, he must make purchases, until he gets the new card, on the old card at 25%, and must pay 25% on the existing balance until the debt is paid off. He also has no assurances that the new card issuer won't raise its rate to 25% shortly after he switches.

Competition is also inadequate because buyers have insufficient information as to rates and availability. As stated before, creditors do not advertise rates and many buyers lack the time or stamina to call several different lenders to obtain rate information. Consumers also have false impressions about which institutions will lend to them. Historically, many working class people and minorities were denied credit by banks and so still stay away from banks. Others do not realize that they are eligible for some credit union memberships. Some probably think they do not make enough to qualify for credit cards. Many are probably unaware that savings and loans are now extending consumer credit. When the market is segmented so that borrowers do not take advantage of competition, they fall prey to unscrupulous lenders even though other lenders may compete. This is why some ceiling is essential.

The Interagency Task Force recognizes the lack of competition in noting that "it is important that unwary buyers be protected from unscrupulous lenders." Where there is a lack of competition "disclosure requirements are not a sufficient safeguard."[28] The Task Force affirms the "need to safeguard the interests of those more vulnerable." Recognizing that

removal of usury ceilings may result in exhorbitant rates if competitive markets do not exist, the Task Force suggests

> [S]hould there be continued concern over protection for consumers from clearly monopolistic practices, then a substantial raising of permissible rates might be preferable to a complete elimination of ceilings.[29]

B. Competition Does Not Exist In Low-Income Markets.

Even if Congress could act to stimulate competition in some credit markets[30], it is extremely unlikely that it could improve competition in the low-income market. Retailers and other lenders do not compete over credit rates because frequently there is only one lender. Banks and finance companies do not have branches in poor neighborhoods. There are no department stores and rarely any used car lots. Grocery stores and clothing stores exist but rarely provide credit. Given the size and poverty of the population, the community generally can support only one furniture store. If another opens up, both may go out of business because people do not have enough spending money to keep both profitable. With only one furniture store, that store can charge whatever it wants.

The furniture store need not fear that its high interest rates will cause a loss of customers to other stores for several reasons. Other stores in other communities are too expensive, too hard to reach or far away, or located in wealthier communities seen as unfriendly to outsiders. Those who do go outside their communities also stay away from lenders they perceive as willing to lend. For example, they often are discouraged by the formality of bank employees and imposing bank lobbies. While one can argue that more lenders will enter low-income neighborhoods if lending there becomes profitable, the facts do not bear this prediction out. Higher profits have not encouraged lending at reasonable rates in poor communities in Arizona. Despite the number of used car dealers selling in low-income communities there, the interest rates remain high.

Additional proof that competition does not exist comes from, the 1977 Consumer Credit Survey. That study, sponsored by the FRB, indicated that only 30% of potential borrowers shop for loans and most choose lenders on the primary basis of proximity and familiarity. The most prominent and largest study, by the National Commission or Consumer Finance, recognized structural features of the consumer credit industry which weakened competiton.[31]

The National Commission on Consumer Finance views rate ceilings as necessary if there is inadequate competition and lists the barriers to competition, two of which are the "convenience and advantage" laws restricting entry of consumer finance companies and the acquisition of finance companies by banks in areas where banks can establish their own small loan offices.[32] Since preemption does not affect the "convenience and

advantage" state laws and nothing prohibits the purchase of finance companies by banks, removal of ceilings is unwise.

When markets are truly competitive over price and borrowers have full information on the "cost" of default, truely competitive markets are in the consumer's interest. But when markets are not fully competitive on price or terms, government regulation is essential to protect consumers by turning the market in the direction of competition or to assure, through ceilings, that the prices and terms on which consumers deal are fair.

C. Noncompetitive Rates Will ause Homeovwers to Lose Their Homes.

In talking about high rates, we are not talking only about money. Many people are going to lose their homes - if S.1406 goes through. Most new lending is secured by second mortgages. Second mortgages are growing by about 25% a year. Second mortgage lending increased from $220 million in 1976 to $5 million in 1979. In 1975, 25% of the loans by Beneficial Finance Companies were secured by homes. Today, 75% are. High interest rates contribute to this trend in several ways. First, higher rates result in higher monthly payments[34] Higher monthly payments by the borrower increase the lender's need for security. Let us return to the earlier example of the borrower earning $15,000 a year and who can afford payments of $310 but not payments of $342. If the borrower has a home which can secure the automobile purchase loan, the creditor may lend him money. The creditor will take this risk if the loan is secured. This example of a borrower risking his home to buy a car is not farefetched. A Florida auto dealer was reported in Automotive News as financing auto purchases with mortgages on the purchasers homes. Perhaps this is one reason auto sales are suffering. In this way higher interest rates result in higher monthly payments and the need for creditor security.

Costly home improvement loans for aluminum siding or insulation, frequently for $10,000 or more often carry very high interest rates and result in many defaults.

Second, since high rates discourage borrowing, finance companies have countered (and increased their share of the consumer finance market) by persuading consumers to borrow on the equity in their homes. The finance industry has learned how to profit from dramatic inflation-caused increases in housing values by persuading people to borrow. Advertisements urge homeowners to unlock the equity in their houses. The largest bank in Tucson, Arizona has been conducting a television and billboard campaign urging homeowers to "let your home give you a present." Pictures and video show a house with a large red ribbon around it and a husband providing his wife and children with a swimming pool, a television, and an expensive bike.

Second mortgage lending is risk-free because of the equity in the house. Even if a borrower has no source of income and no means of repaying the loan, and would be viewed by most lenders as high-risk, the second mortgage lender will view the loan as risk free because the lender will always recover the money by selling the house.

Unfortunately more and more homeowners are unable to repay the ever more risky home loans and lose their homes. Bankruptcies are rising in part due to efforts to save people's homes. If ceilings on second mortgages are preempted and rates increased, the number of defaults (and home foreclosures) increase. First, the number of contracts providing for balloon payments (contracts in which the final payment is greatly in excess of other payments) increase and the balloon payments are larger. When the second mortgage ceiling is 12%, a $10,000 loan can be paid off in 5 years with monthly payments of $237.90. When the interest rate is 36%, that same loan and repayment schedule result in a balloon payment of $22,647.24. Do people actually sign loans calling for such high interest rates and large balloon payments? Two elderly Arizona couples, one on social security and the other living on a janitor's salary, each signed a contract calling for a balloon payment of over $12,000. A third low-income person signed a note with interest of 42% and gave his home as security.

Second, with high interest rates more contracts are negatively amortized. This means that the principle and interest are so high in relation to the payments, that the consumer does not even manage to cover interest as it falls due of some. Some wealthy taxpayers use negatively amortized loans to reduce tax liability but the average consumer cannot afford to pay off a negatively amortized loan. A $10,000 loan for 5 years at 36% requires monthly payments of $300 to cover interest alone. Smaller payments result in the consumer owing more upon termination of the contract than at commencement. The typical consumer does not understand this and is often unable to repay the loan. The speculator then can foreclose on the security--the home--at a distress sale price. When the rates is a reasonable 15% on a second mortgage, a monthly payment of $239.90 retires the principle. When rates are low, negative amortization is difficult to conceal because the low monthly payment tips off the consumer or the amount to be repaid is low enough that the consumer can borrow elsewhere and repay it, avoiding foreclosure.

The real tragedy in these home foreclosures is that for the working and middle class homeowners the home and social security payments are the only source of income for retirement. The Social Security System is reported to be going bankrupt and even if it is not it is clear that funds are not great enough to keep pace with inflation. These people need their homes as a source of income and if they lose them now when they are working, in an attempt to make ends meet, what will they do if they when they retire?

IX. High Interest Rates Exaggerate Old Credit Abuses and Allow New Ones to Develop.

Unlimited rates encourage unscrupulous creditor practices, and increase defaults and oppressive collection practices.

Unlimited rates bring speculators into the market, provide a profitable environment for deceptive practices and enable the unscrupulous lender to unload bad merchandise. When rates are very high speculators who have no previous interest in the consumer credit field enter the market with high-risk, high-rate loans to gouge consumers.

Since rate ceilings were removed in Arizona,[35] home equity lending scams have boomed. Speculators are making fully secured second mortgage loans at 47%. (In other states mortgages have not gone above 16% and mobile homes can be refinanced for 14 to 16% because exploiters are kept out of the market by state laws and usury ceilings). Such loans are considered low risk because of the security of the borrower's equity in their home. Prior to Arizona's removal of usury ceilings the maximum rates for loans of more than $5,000 had been 12%. Naive homeowners are being taken advantage of by these unscrupulous lenders. Two Tucson homeowners who signed notes with balloon payments of more than $12,000 obtained the loans from mortgage brokers who lend up to 80% of the equity in the house under a contract with a large balloon payment. The brokers seem not to care who gets the home when the consumer defaults as long as they get their money. Although no statistics are available, one would expect default rates to be high and in fact a number of mortgage foreclosure cases have been filed.

Under another scheme unscrupulous lenders offer to lend homeowners facing foreclosure the money necessary to prevent the foreclosure on the condition that the homeowner pay the lender the money plus interest at the end of one year. The person cannot repay the loan in one lump sum and defaults and the lender gets the house. Obviously, any time the real estate market is as profitable as it has been for the last few years and real property ownership can provide quick profits, dishonest people will be drawn in to this unsavory commerce.

The high rates enable the speculator to get possession of real property. First, the homeowner must repay more money in interest charges than he would if the rates were lower. This increases the financial burden and likelihood of default. Second, a consumer defaulting on a high-rate mortgage cannot as easily refinance with another creditor to avoid foreclosure as he could if rates were lower. Interest costs mount up more quickly so borrowing the money elsewhere is more expensive and therefore more difficult.

High rates also enable the seller operating in a non-competitive market to unload bad merchandise. Using the experience in Arizona again, used car dealers typically buy cars at less than trade-in book value and sell them at retail book value, so the seller gets his investment back by the second payment.[36] Each payment after that is pure profit on the sales price of the car or on the loan. Many dealers do not expect the consumer to pay off the loan but instead engage in "churning". In churning the seller plans to profit on the buyer's default. The buyer stops paying because the car is defective or the consumer was such a bad risk that he should never have been given money in the first place. The seller repossesses the car, sells it to himself at a loss, sometimes sues the buyer for the deficiency but always resells the car at a profit. Thus he makes a profit on the sale to the first buyer and on the resale to a second buyer.

The lucrative nature of these rates is suggested by the fact that at the time the rate ceilings were lifted car dealers started advertising more extensively their desire to buy cars. They are making so much money when they sell cars that they want to buy in order to sell more. The inflated new car prices also encourage some buyers to buy used cars instead of new ones.

Some proponents of preemption argue that ceilings prevent high-risk consumers from getting credit.[37] The opposite is true. Unlimited rates mean excess credit availability. When there is too much credit and the debt is secured lenders ignore the ability to repay. This is what is happening in Arizona. Those lenders who lent to the McKinneys and the Terrys on notes carrying balloon payments of more thean $12,000, knew those couples have little hope of repaying the loans. They were unconcerned because the houses each have more than $12,000 in equity. The same is true of the used car market. Used car dealers charging 31% APRs state that credit worthiness is not a factor in determining eligibility for credit. The Blue Chip Motors, Inc. advertisement says "No Credit Experience Necessary" with the words "(with required downpayment)" added in small print at the bottom. The City of Cars' advertisement says "We Finance Anyone*, Easiest Place in Town to Buy A Car! Short of Cash? Use our Lay-Away Plan!". The asterick is explained with the words "With Approved Down Payment or Trade In" in smaller print. As mentioned earlier, since the downpayment is high, the price of the car is inflated, and the dealer profits on the credit and property insurance commissions, the dealer rarely loses as long as the debtor makes 2 or 3 payments. And if the dealer repossesses he comes out way ahead. Unlimited rates mean too much credit is available and the creditor lends to noncreditworthy buyers.

Unfortunately easy credit harms the borrower. For the noncreditworthy or high-risk borrowers,[39] borrowing carries with it high psychic costs from fear of default and both psychic and material hardship from default. As one consumer credit expert notes:

> There is substantial evidence showing significant shame and anguish arising from default, some of which seems traceable to the debtor's own perception of himself as a failure[38]

High-risk credit with its harmful psychological effect upon defaulters and their families can be viewed like harmful drugs or defective products and banned from the marketplace.

This country bans thalidomide and laetrile precisely because people are desparate and under such circumstances will take high risks. It is also appropriate to prevent the high risk consumer who is desperate to pay off other debts or to buy goods from getting further over his head. As Prof. Wallace states:

> Elsewhere in the consumer market we have restricted the availability of certain products because it is thought that the only effective protection for the consumer is to ban the product completely. Credit - particularly high price, high risk credit - might be similarly viewed.[39]

Numerous studies show that the vast majority of defaults occur due to events beyond the debtor's control--job loss, illness, and marital trouble.[40] The majority of defaulters default not because they are able to pay and choose not to but because they simply do not have the money. Little is gained by imposing psychic harm of collection upon the debtor. In addition, the costs of protecting the debtor from financial disaster--bankruptcy, TIL claims, exemption statutes, debt collection states--are expensive. To prevent this harm and expense, our credit system should forgive all but willful default in the same way that insurance protects against no fault injury. Low ceilings promote such a system because they discourage the improvident extension of credit and the smaller profits to be gained by collecting on a low-rate loan discourage overly aggressive collection efforts.

The experience in states without usury ceilings makes it clear that a responsible proposal to raise interest rates must include protections for gullible, desperate, and unsophisticated consumers.

Proponents of preemption argue that people ought to be allowed to take these risks. Unfortunately, it is the low-risk consumer who pays higher interest rates so that high-risk consumers can be allowed to borrow. If state ceilings are preempted, rates will go up for everybody. Lenders do not have different rates for different consumers. A few lenders may have one rate for a secured loan and a different one for an unsecured loan, but no one has one rate for the unsecured consumer who borrows a small amount of money relative to his income and a different rate for the consumer who borrows a large amount relative to his income. The Report by the New York Banking Department[41] on rates showed that lenders did

not charge different rates based on the risk of the borrower. As a result, good credit risks will pay high rates to ensure the availability of credit not to themselves but to high risk borrowers. Secured borrowers will subsidize unsecured borrowers.

X. Preemption Will Wreck Havoc on the Consumer Protection Schemes of the 50 States.

Preemption will wreck havoc on the consumer protection schemes of the 50 states, even though it claims to keep existing protections in place. Most states now have a delicate balance between interest rates and consumer protection. The degree and type of regulation of contract terms is tied directly to the maximum level of interest rates allowed. For example, the interest rate that may be imposed is often linked to the type of security taken; whether attorneys' fees can be charged is frequently linked to the interest rate.

As a general rule, states with high rates have many consumer protections. This is because generally states with high rates have thought it appropriate to prevent the worst abuses of desparate or naive consumers by fly-by-night lenders by placing restrictions on unfair and deceptive creditor practices. Massachusetts is one example of a high-rate state with extensive consumer protections. Massachusetts has no rate ceiling for banks (except that banks making loans under $6,000 are covered by the small loan law). The small loan statute itself provide for a high rate - 23% plus $15 dollars. At the same time Massachusetts has a good highly protective statutes on garnishment and exemptions from execution. For example, its small loan law limits late fees and prohibits the pyramiding of late charges. It requires that the lender rebate unearned interest upon early payment and requires that the lender use a particular rebate formula. It prohibits small loan licensees from taking second mortgages and it regulates many other aspects of second mortgage loans. In addition, case law prohibits the award of attorneys fees against consumers in many instances.

States with low ceilings, for example, Arkansas, do not have many restrictions on creditor practices because low rates have made unscrupulous practices unprofitable. Nor do these states have many restrictions on debt collector practices because defaults are not as frequent. Low rates also make collection less profitable.

If ceilings are lifted, states with low rates and low credit burdens will experience the unscrupulous practices rampant in Arizona without the consumer protection statutes designed to curb such practices. Such disruptive federal intervention is hard to justify.

Those who have closely studied the matter have always recognized that the elimination of rate ceilings will upset the balance between creditors and consumers. The National Commission on Consumer Finance combined its rate ceiling proposals with extensive proposals for consumer protection in apparent recognition that the market economy will not provide this protection. If the federal government intervenes (and NCLC believes it should not), it should do so in a way that minimizes the chances of abuse and provides remedies for consumers if abuses do occur.

XI. Preemption of Ceilings and an Increase in Rates Will be Harmful to the Economy

Many witnesses before this Subcommittee and before the full Committee in May recognize that the real problem is inflation.[42] Given this, the proposed solution is doomed. In the first place, federal preemption of ceilings and an increase in rates will have an inflationary effect in itself upon the economy. Interest ceilings are the last bastion against the lender's ability to market credit at higher and higher rates. Without the usury ceilings lenders will endlessly make credit available at progressively higher rates.[43] A sudden large expansion of credit in low-rate states could increase advertising by retailers and lenders spurring the demand for consumer durables and heating up the economy. Consumers can expect to fuel inflation further by borrowing whenever their expectations of continued inflation make high-rate credit look "cheap". Increased consumer prices could further decrease the incentive to save, reducing the capital available for investment. This in turn increases inflation and provokes another round of rate increases.

Preemption will also force the consumer to compete in an unconscionable situation. It is the huge amount of borrowing by big government and big business which drives up the price of credit. Only one example of this is the $11.5 billion in credit arranged by Texaco and Mobile in their bid to buy Conoco. Seagrams and DuPont are also competing and have arranged for similar sums of money to fund their takeover bids. This $25 billion in credit is equal to more than 10% of the $213 billion dollars of consumer credit outstanding. Consumer borrowing is minuscule compared to business and government borrowing yet it is the latter that are driving up costs for consumers. As Rep. St. Germaine stated recently in a letter to FRB chairman Paul Vocker,[44] such borrowing is "particularly questionable" and comes at a "very inappropriate moment". Consumers have no hope of influencing the cost of credit. They can control how much others borrow, and they can't negotiate lower rates.

Business lending is also less expensive because of efficiencies of scale. The large administrative costs are incurred in every

loan transaction and thus make larger loans more profitable. Therefore, if ceilings are preempted the consumer will pay more than business and government do.

It is also unclear that preemption will promote the economic stimulation for which it is being touted. Instead, it could provoke a business decline if rates are so high that potential borrowers realize they cannot afford the new high priced credit. For example, the housing industry has been suffering for several years because of high interest rates. Mobile home sales in 1980 when interest rates shot up were down by 20% from the previous year. Preemption of usury ceilings may have increased the availability of credit, but rates are now so high that people do not want to or are unable to make the payments.

We need planning of monetary and fiscal policy to prevent any decline. Given the present condition of our economy, it may be unwise for the federal government to act precipitiously without coordination with monetary and fiscal authorities. Any federal intervention must address this concern.

Preemption and unlimited rates will lead to increased numbers of defaults and bankruptcies.[45] Not only is the cost higher but more higher-risk consumers are able to borrow. This will have an adverse impact on business. The legitimate businesses that lent money unwisely will suffer, leaving only the loansharks. And since the bankrupt discharges all his debts, all other businesses that extended credit but did not do so improvidently, including landlords and doctors, will be affected. When a consumer falls deeply into debt there are farreaching consequences for the economy.[46]

XII. <u>Preemption is Premature Without Study by a Usury Commission.</u>

Last session Congress considered establishing a commission to study the economic and social effect of federal preemption of state usury ceilings. A study of consumers' concerns, the question of existing credit profitability, and the ragged state of protections from credit abuses such as prepayment penalties, negative amortization, and credit insurance rates is crucial.

Any law designed to preempt should be narrowly drafted, as S. 1406 is not, to interfere with state legislation as little as possible but carefully drafted to stimulate competition and avoid litigation. This should be the task of a study commission and federal preemption should not be hastily accomplished before this work is completed.

Preemption raises difficult questions about the relationship between federal and state government. It will seriously disrupt consumer protection scheme hammered out over decades between consumer and creditor interests. Raising as it does difficult and troubling questions about federalsim and respect

for democratic principles federal preemption should be avoided without a conclusion by a study commission that the results are necessary and can be accomplished in no other way.

1. The author of this written statement, the National Consumer Law Center, Inc. ("NCLC") was established in 1969 to render legal and expert assistance and support on interest rate and other consumer issues to the more than 6000 attorneys who provide legal assistance to low-income consumers through legal services programs now funded through the Legal Services Corporation.

2. NCLC's statements and arguments about federal preemption are intended to address only existing usury ceilings, and do not speak to past federal preemption of loans secured by first mortgages.

3. 7/21/81 Statement of Henry Schecter, AFL-CIO, pp 9-11.

4. Id.

5. Id.

6. Benston, George J., "The Impact of Maturity Regulation on High Interest Rate Lenders and Borrowers," Journal of Financial Economics, January 1977 at p. 44.

7. Value Line Investment Survey, Part III Ratings & Reports, 4,3,81 p. 102.

8. Id.

9. Purchasing power of wages has been on a sharp downtrend due to inflation, taxes, and Social Security levies accorfding to the Value Line Investments Survey, id.

10. Installment debt throughout 1980 was 16-17% of disposable income. Value Line Investment Survey, Part III Ratings & Reports 4/3/81 p. 101.

11. Automotive News, "GMAC's Role Being Broadened", p. 6 March 30, 1981

12. Federal Reserve Bulletins, Table 1.57.

13. April 28, 1981 statement of Lawrence Connell, Chairman, National Credit Union Administration Board, before the Committee on Banking, Housing and Urban Affairs of the U.S. Senate, p.3.

14. The details of the survey are not described and thus questions about the structure of the survey, the framing of the issues, the phrasing of the questions, the representativeness of the sample, and the accuracy of the data must remain.

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15. Goudzwaard, Maurice B., "Rate Ceilings, Loan Turndowns, and Credit Opportunity," 6 Western Econ. J. 404 (1968).

16. Editorial "Is Price the Answer", p. 18, 2/23/81.

17. Wall Street Journal, May 7, 1981, p. 1.

18. Federal Reserve Statistic Release E 10(120).

19. We have already discussed the reasons preemption will not help for new car industry.

20. 4/28/81 testimony of Comptroller of the Currency John Heimann before the full Committee, p. 14.

21. Statement of Vernon Dwyer, Sec, Nat'l Ass'n of Fed. C.U., July 15, 1981, p.2.

22. Statement of VISA U.S.A., Inc., July 15, 1981, p.4.

23. 1980 Massachusetts Small Loans Hearings, Department of Banking.

24. James Campen, Exhibit 36, 1980 Massachusetts Small loan Hearings, Department of Banking.

25. December, 1980 net automobile outstandings were $116.327 billion; interest rates can be expected to rise on automobiles by 6% if rates are removed. A 6% increase in interest charges on automobiles totals $6.980 billion. December, 1980 net revolving credit outstandings (banks and gas companies) were roughly $34.718 million and interest charges on them can be expected to rise 8% and cost consumers $2.777 billion. Interest on retailer revolving charges (net) can be expected to rise 8% and outstandings in December, 1980 were $25.114 billion, so additional interest charges would equal $2.009 billion. New outstandings are roughly $29.075 billion and interest rates thereon can be expected to rise 10% or $2.9075 billion. Usury ceilings on mobile home credit are already preempted.

26. A New York Banking Department, Report on Survey of Interest Rates and Charges on Consumer Credit (February, 1981) at 40-41.

27. Id.

28. Interagency Task Force on Thrift Institutions, Report 66 (1980).

29. Id. at 72.

30. See Revolving Credit & Electronic Systems Letter, April 11, 1980.

31. National Commission on Consumer Finance, Consumer Credit in the United States (1972) p. 137-38, 147.

32. Id.

33. Business Week, 3/16/81 p. 126.

34. If the payment is not higher, then the repayment period must be longer. The longer the repayment period, the greater the likelihood of default and thus the greater the need for security that will be as valuable throughout the course of performance of the contract as at the commencement of the loan.

35. The usury ceilings were removed so recently in the other states that it is too early to determine the effect.

36. Most dealers pay less than book trade-in value for used cars, and, if they finance them, do so in such a way as to get their investment by the second payment. Even if we assumed that dealers paid book trade-in value for the cars they are selling, dealers get their investment back by the fourth or fifth payment. One Arizona dealer advertised a 1975 Vega (with a trade-in value of $700) for $995 with a mandatory downpayment of $350 and monthly payments of $81. After the downpayment is made the out-of-pocket cost is $350. Each of the 12 remaining payments are profits for the dealer. An examination of advertised used car prices (Appendix C) will show that this example reflects a pattern with used cars.

37. High-risk or noncreditworthy consumers are not equivalent to low-income consumers. A $1000 loan to a person earning $10,000 may be a better risk than a $6000 loan to a person earning $25,000. Moreover, credit scoring systems used by large financial organizations--banks, finance companies, savings and loans--do not count income very heavily. Length of employment and of residence are much more heavily weighed.

38. Wallace, Geo., The Uses of Usury: Low Rate Ceilings Reexamined, 56 B.U.L. Rev. 451, 459 n.33 (1976). Mr. Wallace continues: "For a collection and discussion of the authorities see Wallace, "The Logic of Consumer Credit Reform, 82 Yale L.J. 461-72 & nn. 23-30 (1973).

39. Wallace, Geo., The Uses of Usury: Low Rate Ceilings Reexamined, 56 B.U.L. Rev. 451,458 (1976) Footnotes deleted

40. Greer, Douglas F., "Creditor's Remedies and Contract Provisions: An Economic and Legal Analysis of Consumer Credit Collection," National Commission on Consumer Finance: Technical Studies, Vol. V., Govt. Printing Office, n.d.

41. See New York Department of Banking, Report on Survey of Interest Rates and Charges on Consumer Credit (February, 1981).

42. Statement of Richard Lawton of The National Savings and Loan League 5/7/81 before the full Committee, p.2; see 4/28/81 testimony of Treasury Secretary Donald Regan before the full committee, p.2; see 4/28/81 statement of Frederick Schultz of the Federal Reserve Board before the full Committee, p.3.

43. An analyst of the credit industry stated that lenders were pushing for higher rates and counted on the fact that rate ceilings, once raised, would not come down even if the prime were to drop. See Revolving Credit & Electronic Systems letter, April 11, 1980.

44. American Banker, "St. Germaine Bids Fed Halt Merger Spree", July 16, 1981, p.1.

45. Bankruptcies were up in the perriod ending June, 1979, by 14,3%. Payment Systems, Inc. Newsletter, December , 1979 P.3.

46. ABA BAnk Card Letter, "Holiday Advertisement on Credit", December, 1979 P.2-3.

APPENDIX A
SMALL LOAN(1)

STATE	FINANCE CHARGE	APR(2)
AL.	502.17	22.5
AK.	490.15	22.0
AZ.	---(3)	---
ARK.	214.96	10
CA.	508.24	22.76
CO.	638.35	28.16
CN.	511.84	22.91
DE.	---(3)	---
D.C.	327.36	15
FLA.	551.44	24.58
GA.	577.84(4)	25.66(4)
HA.	711.76	31.13
ID.	681.69	29.92
ILL.	496.24	22.27
ND.	512.83	22.95
IA.	500.25	22.42
KA.	567.76	25.25
KY.	657.76	28.94
LA.	804.88	34.84
ME.	553.84	24.67
MD.	522.18	23.35
MA.	533.92	23.84
MI.	447.76	20.21
MN.	487.60	21.89
MS.	913.48	39.09
MO.	367.36	16.75
MT.	---(3)	---
NE.	495.52	22.23
NV.	512.56	22.95
N.H.	---(3)	---
N.J.	561.94 (5)	25
N.M.	1068.27(6)	45
N.Y.	683.88 (7)	30
N.C.	555.84	24.75
N.D.	---(3)	---
OH.	591.02	26.21
OK.	554.07	24.68
OR.	606.16	26.84
PA.	487.60	21.89
R.I.	537.81	24
S.C.	556.	24.76
S.D.	--- (3)	--- (3)
TN.	493.12	22.13
TX.	537.81	24 (8)
UT.	645.28	28.43
VT.	445.44	20.53
VA.	685.60	30.07
WA.	467.92	21.06
W.V.	466.51	21
WI.	452.32	20.40
WY.	512.56	22.95

(1) The finance charges and APRs provided are based on a loan of $2000 repayable in 24 equal monthly installments.

(2) Rate is highest rate that lender can charge. Thus, if two statutes are applicable, the figures given are for the statute with the higher rate.

(3) Arizona has no ceiling so rates could go up to the 31% now charged by some used car dealers, to 51% charged a woman on an Indian reservation, or to the 208% reported in the New York survey of credit rates. The same is true of Delaware, Illinois, Montana, New Hampshire, New Jersey, New York, New Mexico and North Dakota.

(4) Does not include maintenance fee of $2 month; such insclusion which would increase APR.

(5) New Jersey has a criminal usury statute prohibiting rates over 30%.

(6) Criminal usury

(7) New York has a criminal usury ceiling of 25%.

(8) This has a floating ceiling. That ceiling is now 24%.

APPENDIX B
AUTOMOBILE LOAN (1)

STATE	FINANCE CHARGE (2)	APR (2)
AL.	$1072.36	18.27%
AK.	1118.66	51
AZ.	---- (3)	19
ARK.	565.67	10
CA.	1260	21
CO.	1213.16	20.48
CN.	1509.97	25
DE.	----(3)	---(3)
D.C.	1734.04	28.33
FL.	1785	29.07
GA.	1785	29.07
HA.	1884.52	30.52
ID.	1462.24	24.29
IL.	1680	27.53
IN.	1371.52	22.91
IA.	1644.22	27
KA.	957.52	16.45
KY.	1575	25.98
LA.	1680.22	27.53
ME.	1410.70	23.5
MD.	1644.22	27
MA.	1260	21.2
MI.	1312	22
MN.	1367.92	22.86
MS.	1763.39	28.75
MO.	1365	22.81
MT.	---- (3)	---(3)
NE.	1055.20	18
NV.	----(3)	---(3)
N.H.	----(3)	---(3)
N.J.	1509.97(4)	25(4)
N.M.	2842.07(5)	45
N.Y.	1849.16(6)	30(6)
N.C.	1360.88	22.75
N.D.	---(3)	---
OH.	1055.20	18
OK.	1247.06	21
OR.	1260	21.2
PA.	1260	21.2
R.I.	1247.06	21
S.C.	1680.00	27.53
S.D.	1644.22	27
TN.	1055.20	18
TX.	1443.34	24
UT.	1426.24	24.29
VT.	1182.61	20
VA.	1443.34	24
WA.	1215.13	20.5
W.V.	1247.06	217
W.	1394.09	23.25
Wy.	1165.24	19.73

(1) Rates and finance charges shown are based on sales finance statutes rather than loan statutes. It assumes the purchase of a car more than four years old, purchased for $3500, and financed over 4 years.

(2) Does not include all the profits a lender makes on commissions on credit insurance and property insurance; nor does it include all the other charges the buyer pays, such as application fee, credit report, license and title fees.

(3) Arizona, Delaware, Montana, Nevada, New Hampshire and North Dakota have deregulated these types of loans so any APR and any finance charge is possible.

(4) New Jersey has a crisinial usury statute of 30%.

(5) New Mexico has a criminal usury statutory maximum of 45%. This finance charge is based on 35 month financing of $3500.

(6) New York has a criminal usury statute of 25%.

(6)

April 7, 1981

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UNITED STATES LEAGUE of SAVINGS ASSOCIATIONS WASHINGTON OFFICE
1709 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. [illegible] / TEL. [illegible]
ARTHUR B. EDGEWORTH
Director, Washington Operations,
Washington Counsel

July 21, 1981

The Honorable John Tower
Chairman, Subcommittee on Financial Institutions
Committee on Banking, Housing and Urban Affairs
United States Senate
Room 5300 DSOB
Washington, D. C. 20510

Dear Chairman Tower:

On behalf of the United States League of Savings Associations and its 4 400 member savings and loan associations, I am writing today in support of S.1406 -- a bill to preempt State-imposed usury ceilings on consumer credit, and to remove the indexed rate limitation (while granting permanent effect) for the preemption adopted in the last Congress for business and agricultural credit.

The U.S. League applauds the initiative of Senator Lugar, Chairman Garn, Senator D'Amato, and Senator Proxmire of the full Committee n sponsor ng S. 1406. Federal preemption is the best approach to overriding the anachronistic and artificial barriers which usury laws present to the free flow of consumer, agricultural and business lending Our credit markets are increasingly nat onal n scope and the extraordinary interest rates commanded today on Wall Street are soon reflected in the cost of credit throughout America.

Importantly, S. 1406 preserves the right of States to reassert usu y ceilings if they wish But, by forceful Congressional action now, you can relieve the distortions which usury statutes create. The evidence is overwhelming that usury laws perversely deny credit to consumers in many states during this period of exceptionally high market rates of interest.

As you know, savings and loan associations are primarily morgage lenders. Their principal credit activity involves first liens on residential real property and as such is covered by the preemption of unlim ted duration contained in Section 501 of last year s Depository Institutions Deregulation and Monetary Control Act (Public Law 96-221) The coverage of that important section, however does not extend to unior liens or consumer financing. These are lending areas of growing importance to the communities our institutions serve.

The Honorable John Tower
Page 2
July 21, 1981

Indeed, a major thrust of Public Law 96-221 was to encourage Federally-chartered savings associations to diversify and shorten their asset structure by authorizing consumer lending to 20% of assets. The 96th Congress felt that this diversification was essential if S&Ls were to adjust to a new world of deregulated savings deposits, as called for in Title II of P.L. 96-221. That purpose is being frustrated today by the presence, in a number of jurisdictions, of inflexible, below-market usury limits on non-mortgage financing.

One does not need to be a financial expert to recognize that financial institutions cannot survive over time to serve future customers if they must continually pay their depositors more than they charge their borrowers. It was in recognition of this fact that P.L. 96-221 provided a usury override for mortgage loans. Market rates were so much above maximums established in some States that borrowers seeking to purchase and finance homes were unable to find lenders willing to make such loans.

The need for a similar usury override exists in connection with consumer loans from regulated, licensed, and supervised depository institutions. Where the rate maximums placed upon lenders are too low, the result is not the type of consumer protectio envisined by such maximums -- but rather a shortage of funds to the disadvantage of those consumers who want to borrow. The solution to this problem is S. 1406.

Before concluding, I have one minor suggestion for the definition of "creditor" appearing in Title II of S. 1406. It might be helpful, as a matter of clarification, to recite that supervised depository institutions are "creditors" within the meaning of Title II. In many states, supervised financial institutions -- because of their frequent examinations by State and Federal officials -- are exempted from licensing requirements. The definition now appearing in Title II could conceivably be misunderstood to exclude from coverage unlicensed, though highly supervised, depository institutions. I am sure that was not the intent of the drafters of S. 1406. The matter would be easily rectified by inserting "or depository institution" after the word "person" in the first sentence of Section 532 (a)(3); there is no need for defining "depository institution" since that definition appears in Section 501 of P.L. 96-221 (the statute being amended by the Consumer Credit Title II).

The Honorable John Tower
Page 3
July 21, 1981

The passage of S. 1406 would complement the progress already achieved for mortgage lending through P.L. 96-221. It would enable savings and loan associations in many states to begin to diversify their asset structure. It would benefit consumers -- both borrowers and savers -- by improving the competitive equality among the different types of institutions and steadying the flow of lendable funds throughout the interest-rate cycles.

In closing, we again applaud the efforts of Senator Lugar, and his cosponsors Senators Garn, D'Amato, and Proxmire, for recommending S. 1406 to your Subcommittee and the Congress.

I would appreciate your assistance, Mr. Chairman, in adding this letter to the hearing record on S. 1406.

Sincerely,

Arthur B. Edgeworth
Director, Washington Operations

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
WASHINGTON OFFICE
SUITE 200, 1709 NEW YORK AVENUE, N.W.
WASHINGTON, D.C. 20006
TELEPHONE (202) 785-8144

NAMSB

July 27, 1981

JUL 28 AM 11:13

The Honorable John Tower, Chairman
Subcommittee on Financial Institutions
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The National Association of Mutual Savings Banks takes this opportunity to endorse the pending legislation, S. 1406, that would preempt state usury ceilings on extensions of consumer credit. We believe that such an approach would be a constructive step toward improving the overall business climate for the delivery of financial services to consumers.

Mutual savings banks are primarily residential lenders, and in many cases are relatively new entrants to the consumer credit market inasmuch as it has only been in the last few years that state legislatures and more recently the federal government have begun to modernize thrift institutions by granting them authority to offer a broader range of financial services. Although the consumer credit market is already a highly competitive one, mutual savings banks find the market attractive both from the standpoint of improving their overall competitive posture vis-a-vis other types of depository institutions, and from the standpoint of providing greater balance to their predominantly long-term asset structure. Thus, consumer installment loans, which for savings banks may be either closed-end or open-end, represent a small but growing and increasingly important percentage of loans outstanding.

NAMSB has long supported a federal policy preempting state usury laws for the principal reason that such laws are counterproductive to the long-run flow of credit to important sectors of the economy. The ill effects of usury statutes have been especially evident in the area of mortgage finance where numerous states, and especially New York, have unwittingly curtailed home building and home lending activities -- in effect, homeownership opportunities for their citizens — by continuing to pursue a policy of unrealistically low interest rate ceilings. Fortunately, the Congress deemed it prudent to step in and preempt existing state usury ceilings on mortgage loans on a temporary basis in late 1979 and then permanently as part of the Depository Institutions Deregulation and Monetary Control Act enacted in 1980. This legislation also provided more limited usury relief with regard to certain business and agricultural loans.

We respectfully suggest that the same compelling reasons which persuaded the Congress to preempt usury ceilings with regard to other types of credit are equally applicable to consumer credit. As mentioned, these reasons involve first of all assuring that credit will not atrophy during periods of high interest rates when returns on non-regulated investments rise above usury ceilings Secondly elimination of usury ceilings will permit financial institutions to earn a fair-market return on loans which are made in their local communities, a type of lending which has been given special emphasis through enactment of the Community Reinvestment Act Moreover, now that the Congress has clearly, and in our view appropriately embarked on a policy of deregulating financial institutions by phasing out ceilings on interest rates payable to depositors, it is absolutely essential that the remaining restraints on bank earnings be likewise eliminated.

We also support Title I of this legislation which constitutes a significant improvement over the current approach to federal preemption of usury ceilings on business loans which requires a minimum amount and is tied to the administration of the Federal Reserve discount rate It would, in particular address the situation which exists in New York and several other states wherein loans for business purposes are not exempt from usury statutes unless the borrower is doing business in the corporate form of organization.

Title II of the bill, which preempts limitations on finance or other charges imposed in connection with consumer credit, would likewise be a significant improvement over current federal authority which for savings banks is primarily vested in Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 Here again, we are dealing with a statute which is tied to the discount rate and which is difficult to administer because of the varying interpretations which have arisen under the "most favored lender" doctrine. We believe that Title II could be drafted even more simply than is now the case, and would go as far as to question the need for Section 534 of the bill which vests the Federal Reserve Board with rule-writing authority under the legislation. We would prefer to see a straightforward, self-enforcing statute.

As a final comment in the area of federal preemption, we would commend your attention to the problem caused by state laws prohibiting "due on sale" clauses in mortgage contracts. Along with usury ceilings, state statutes of this sort continue to discourage mortgage lending and impair the viability of institutions which are disposed by practice or law to channel a significant amount of their funds into home loans.

We respectfully request that this letter be made a part of the hearing record. Thank you for the opportunity to express these views.

Sincerely yours,

James J. Butera
Vice President and
Associate Director

NEW YORK CLEARING HOUSE

100 BROAD STREET NEW YORK, N.Y. 10004

JOHN F. LEE
EXECUTIVE VICE PRESIDENT

July 21, 1981

The Honorable Richard G. Lugar
United States Senate
5107 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Lugar:

I am writing on behalf of the New York Clearing House Association, an association composed of 12 major commercial banks located in New York City. Our member banks strongly support S. 1406. The bill recognizes that antiquated, inconsistent state usury limitations have a counterproductive impact throughout the United States generally and particularly on consumers and smaller businesses situated in states with the most rigid usury ceilings.

Most state usury laws were adopted when general market interest rates were dramatically below the rates prevailing over the last several years. Under present circumstances, the cost of funds to financial institutions frequently exceeds the lending rates permissible under usury laws.

Out-of-date usury ceilings produce significant negative effects on those they are meant to protect and on the economy generally. First, many financial institutions hesitate to lend funds at a "negative spread", and those few loans that are made tend to go only to the best credit risks. Consumers, farmers and smaller businesses are finding it difficult, in many cases impossible, to obtain financing for such fundamental needs as children's education, unexpected medical expenses, automobiles, business expansion and other similar items. Ironically, laws designed primarily to protect consumers, farmers and small businesses have been working to their detriment.

A second result of outmoded state usury restrictions is their negative impact on the demand for products and services. That impact is felt throughout the U.S.

economy and not only within the boundaries of the state that restricts credit. For example, the inability of consumers to obtain car financing in one state has a direct impact on our nation's car manufacturers headquartered and operating plants in other states.

Finally, provincial state usury restrictions are incompatible with national monetary policy. If interest rates are a tool utilized to cool overheated demand and curtail inflation, and if financial institutions are going to continue to extend credit without impairment of their profitability, all interest rates should move in accordance with monetary policy. One sector should not be subsidizing another sector; one sector should not be deprived of financing because of interest rate ceilings while other sectors have credit readily available. Severe distortions in extensions of credit as a consequence of state usury laws are detrimental to the best interests of the country as a whole.

In conclusion, we strongly support S. 1406 for the reasons stated above.

Very truly yours,

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STATEMENT
on the
CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981 (S.1406)
for submission to the
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
of the
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Ronald D. Utt*
July 28, 1981

The Chamber of Commerce of the United States, on behalf of its more than 158,000 members, welcomes this opportunity to support S.1406 which would amend the Depository Institutions Deregulation and Monetary Control Act of 1980 (the Act) to allow federal preemption of state usury ceilings on consumer credit.

Summary

Usury ceilings represent one of the oldest forms of credit control and, perhaps, one of the most debilitating in terms of their effect on economic activity and their relative impacts on specific income groups. When a usury ceiling is effective, that is, when market rates rise above the established ceiling, credit is either rationed or simply not forthcoming. When rationed, it tends to be available only to those who are well-connected or to those whose wealth or income levels make them especially good lending risks. In either case, the shortfall of credit bears most heavily upon the less influential and those with lower incomes or less wealth.

When usury ceilings vary significantly from one loan type to another or among geographic regions, as they do in the United States, the effect is to channel credit away from the controlled loans and regions to other areas. As a result, some get more while others get less, and the distribution of credit bears little relation to relative needs or productive uses.

---

*Associate Chief Economist, Chamber of Commerce of the United States

Early last year, Congress passed the landmark Depository Institution Deregulation and Monetary Control Act of 1980 which, in addition to its reforms of the banking system, provided for the preemption of state usury ceilings on home mortgages, business and agriculture credit and mobile home loans. The proposals embodied in S.1406 would complete this reform by freeing interest rates on the last significant sector of our credit market still under this adverse form of control--the consumer loan market -- and by providing the same rate-setting freedom to business and agriculture loans as is now applied to mortgage loans under Title V of the Act.

Recent Experience With Ceilings on Consumer Credit

The harmful effects of usury ceilings on consumer loans have become especially obvious over the last two years as interest rates have soared to record. Confronted with borrowing costs that are often above the maximum rates they are allowed to charge consumers, lending institutions have to choose between lending at a loss or not lending at all. In states where they are prohibited from charging a rate that would cover their costs, lenders have been forced to adopt a wide variety of expedient measures that are less than satisfactory for them, for consumers, and for the many indirect participants and beneficiaries of a credit transaction. Since consumer credit availability is an important component of an automobile sale, these ceilings have contributed to the deterioration of an industry already in a precarious position. The same experience has characterized other depressed durable goods industries such as appliances and furniture that are also dependent upon credit sales.

As is so often the case, the households with the fewest resources are the ones most seriously affected. Lender efforts to ration loans by requiring higher down payments, shorter maturities and higher credit standards have a disproportionately greater effect on this group.

In addition to the explicit hardships that are caused by usury ceilings, these controls often work to distort market relationships in ways that create inefficiencies, inequities and

S.963 would permit lenders to charge an interest rate of one percent (100 basis points) in excess of the Federal Reserve's discount rate on 90 day commercial paper when such rate exceeds the maximum rate established by state usury ceilings.

With the discount rate now set at 14%, this would permit lenders to make loans at 15%. Since only five of the forty-four states that apply usury ceilings to consumer loans maintain ceilings below 15%, the bill would offer only very limited relief. Moreover, the 15% ceiling would be well below most market interest rates and below the cost of funds to many lenders. Connecticut, for example, has found it necessary to raise its ceiling on credit card purchases to 18%, its ceiling on retail installment contracts to 21% and the ceiling on certain new car loans to 18%.

With the enactment of S.963, lenders would still be reluctant to make loans at the allowable rate and the consumer sector would continue to be denied access to credit in those states where the usury ceiling is below the market interest rate. For this reason, the Chamber does not recommend the enactment of S.963.

Conclusion

The U.S. Chamber supports S.1406 because the amendment and the act itself represent important steps in reforming the U.S. financial system. Both measures will improve the workings of the financial system and help achieve the goals of greater capital formation and a more efficient allocation of our scarce resources. While some may express concern over the Federal intrusion into the states' prerogative to regulate commerce within their boundaries, the fifteen month history of the initial federal usury override suggests that most states appreciated the relief that the enactment of this law provided their credit markets. Since the law's enactment, only seven states have elected to take advantage of the privilege, provided by the law, to reimpose usury ceilings on mortgage, agriculture and business credit.

STATEMENT OF

NATIONAL HOME IMPROVEMENT COUNCIL, INC.

11 EAST 44TH STREET
NEW YORK, NEW YORK 10017

This is a statement of the National Home Improvement Council in support of S.1406 and S.963 which would extend federal preemption of state usury laws to include consumer loans, particularly home improvement loans.

The National Home Improvement Council is a trade association serving the home improvement and remodeling industry, with headquarters at 11 East 44th St., New York, N.Y. 10017. Membership is approximately 3500: the bulk of that membership is found in more than 50 chapters across the United States, and includes approximately 70 National Members. Those National Members are primarily engaged in manufacturing products for the construction industries and include a number of shelter publications dealing with the home and the many concerns of the home owner. The chapter membership, primarily contractors, also includes utilities, lending institutions and wholesalers.

At the outset, this organization wishes to record its support of the statement of Philip Brinkerhoff, President of the Federal Home Loan Mortgage Corporation, given before this sub-committee on July 15, 1981, and fully endorses the views expressed therein.

I

To understand the import attached to passage of this legislation by the home improvement industry one must first review recent events in the housing and home improvement industries.

As stated in a recent U.S. Chamber of Commerce article, housing demand has been vastly increased by: the maturing of the baby-boom generation, increasing life-spans, declining household size, and the loss of approximately 700,000 housing units a year to such things as demolition, old age and fire. At

the same time, new housing starts have dramatically declined in 1980 and 1981.

This translates into housing shortages and rising median prices. A recent Harvard-MIT study showed that almost half of all American families could afford to purchase a new home in 1970, whereas today, it's estimated that less than 7% of U.S. families can afford a new home.

Previously, such a trend would have been at least partially offset by considerably increased home improvement activity:but not in 1981.

II

As the prime rate has increased in lending institutions across the country, home owners have experienced increasing difficulty in obtaining funds to undertake home improvement projects or energy conservation installations. In at least 22 states--the so called "usury restrictive states"—the explanation is simple. Institutions in these states have had to pay returns of upwards of 15% in order to attract deposits, but are prohibited by state usury laws from lending at equally realistic rates. This has resulted in a virtual drying up of home improvement loans in these areas. In Western Pennsylvania, for example, the chairman of NHIC's local chapter reports that many lenders have terminated their installment loan programs and are unequipped to handle FHA financing. There, and in other areas across the nation, groups such as NHIC are joining forces to press for an update of state usury ceilings.

The Bureau of the Census Report, "Residential Alterations and Repairs"--the usually accepted statistical barometer for the industry--shows total expenditures in 1980 at $46.3 billion, an increase of approximately 10% over the 1979 figure of $42.2 billion. The $4 billion increase fell well short of industry forecasts

of an increase of $6 billion. This decline in the rate of increase occurred at a time when new construction was abnormally low; a time when home improvement would normally rise dramatically. Almost all qualified observers of industry performance attribute 1980's relatively poor performance to the lack of home improvement funds available from normal lending sources; funds halted by unrealistic state usury laws. Recent reports from two leading trade publications, point out that contractors nationwide are singling out inadequate financing - either because of exceptionally high interest rates or the non-availability of loans because of state usury laws-as the most important issue presently affecting the remodeling industry.

1981 performance figures released by the Bureau of the Census in June indicate that first quarter expenditures ($8.7 billion) are substantially below those of the first quarter of 1980 ($9.2billion) on a seasonally adjusted basis, and, indeed are well below those for any quarter of 1980. Again, the functional unavailability of funds resulted because the required market rate returns exceeded state usury levels in almost half of the states. This, in the view of most industry statisticians, accounted for much of the poor performance.

Special importance of these figures lies in the fact that home improvement, rehabilitation and remodeling are the only real answers to our nation's growing housing shortage in the face of a sharp housing starts decline. Most Americans who are actively in the market for housing cannot now afford new construction. Record high prices and unusually high mortgage interest place most buyers out of the new home market. The remodeling of existing homes has to be the realistic answer for most. Recognizing this fact, it become apparent that unless deterrents to home improvement lending are swept away, the nation will find itself in a situation whereby housing inventory will be critically short of demand.

The statement of the Federal Home Loan Mortgage Corporation before this sub-committee demonstrated that a dramatic turnaround took place in the so-called restrictive interest usury states, when federal rates preempted low first mortgage rates under the 1980 Federal Preemption law. A similar result would almost certainly follow were home owners able to fund much needed home improvements and energy conservation installations. Vastly increased home lending activity in New York and other states after a state usury law revision, point to that conclusion.

III

Finally, it should also be pointed out that American home owners have demonstrated more than a willingness to join the vital national crusade for energy conservation. IRS figures and information available through the Department of Energy show that home owners have taken up the conservation cause. Clearly a top priority for this age, energy conservation has been considerably slowed because of the unavailability of funds in many of the nation's housing centers. While the country clearly supports increasing energy conservation in the home, this vital national interest has been heavily hit by the virtual absence of home improvement and energy conservationfunds in the restrictive usury law states.

This legislation would serve as a much needed boost to the quality and availability of the nation's housing. At the same time it would allow home owners to support our nation's energy conservation goals, a central priority in the national commitment towards a long term solution of the energy crisis.

The National Home Improvement Council thanks the subcommittee for this opportunity to submit these views in support of S.1406 and related legislation.

Respectfully submitted for the National Home Improvement Council.

Randolph J. Seifert
Vice President & General Counsel

STATEMENT OF

NATIONAL RETAIL MERCHANTS ASSOCIATION

The National Retail Merchants Association (NRMA) is pleased to have the opportunity to submit this statement for the record in hearings on S.963 and S.1406, legislation offered to address the problems caused by restrictive finance charge rate ceilings.

NRMA is a non-profit national trade association with over 3,500 corporate members. These businesses range in size from small specialty shops to the nation's largest department stores, although the majority of NRMA's members are small businesses with sales of under 1 million dollars annually. NRMA's members operate more than 40,000 department, chain and specialty stores in the general merchandise retail industry throughout the United States and these stores account for over 100 billion dollars in sales annually, at least half of which are credit sales. Every member of NRMA is concerned with the subject of regulation of the cost of consumer credit because virtually all of them extend credit directly through their own plans or indirectly by accepting third-party credit cards.

NRMA advocates the elimination of unrealistically low ceilings upon the permissible rate of finance charges. With respect to the two bills proposed to deregulate the price of credit, however, NRMA cannot support either bill in its present form. The approach of S.963 is unacceptable because that bill would merely provide a temporary preemption of state-imposed rate ceilings until April 1, 1983 and, moreover, a federally-imposed ceiling would be substituted for those currently

mandated by the states. Further, the ceiling proposed in S.963 would be a variable rate (i.e., one percent above the discount rate, including any surcharge, on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve district where the creditor is located). For open end creditors, a variable rate ceiling can present significant operational problems, such as the need for constant modification of computer programs when applying changing periodic rates, allocating different rates to different account balances, modifying millions of account agreements to provide for variable rate financing or, in the alternative, mailing to all accounts notices of change in terms required by state and federal law each time the rate is increased. This approach is so problematic and frought with uncertainty that, in our view, it is far more unacceptable than retaining the status quo. Retailing strongly opposes substitution of regulating the cost of consumer credit on the state level with such regulation on the federal level, and this includes the enactment of legislation imposing any type of federal ceiling, variable or fixed, on the price of credit.

In contrast, we support the concept of deregulation embodied in S.1406. Although NRMA cannot support any legislation which provides for returning to the states control of the cost of credit, because that is conceptually incompatible with the principle that the price of any good or service should be

controlled only by competitive market forces, the approach of S.1406 is vastly preferable to that of S.963.

Congress has taken a number of actions to streamline regulatory programs and make them more responsive to the market. In the past five years regulatory programs that controlled prices have been substantially dismantled in such diverse areas as securities brokerage fees, natural gas, airlines, and trucking. In the field of finance, as you know, the Depository Institutions Deregulation and Monetary Control Act of 1980 provides, among other things, federal preemption of state usury laws applying to first mortgages, mobile home loans and certain business and agricultural credit. Thus, Congress has demonstrated a willingness to remove stringent regulation when it can be shown that the controls cause problems for consumers that would be redressed by permitting the market to set rates. As we will explain in some detail, from the standpoint of retailing problems attributable to restrictive rate ceilings have reached such magnitude that immediate action is justified.

NRMA supports decontrol of the price of credit. When alternative sources for a service are available and information is available on which to base the decision whether and from whom to buy, the market adequately controls rates. As part of the current trend of regulatory reform legislation and administrative action, now is a propitious time to consider abolition of state limits on finance charge rates for consumer credit.

As to the economic question of whether retailers need preemption of state ceilings on finance charges, we believe that this issue should no longer be subject to serious debate.

American consumers now hold more than 300 million charge accounts -- 30-day and revolving -- at retail stores. Thus, the extension of credit has become an integral part of the retailer's business. In some instances, credit represents as much as 75 percent of a retailer's total sales and the average for most retailers exceeds 50 percent.

The operation of revolving credit plans necessarily involves substantial costs, including those in the following areas: the opening of the account, such as evaluation of creditworthiness; the maintenance of the account; the collection of the account, such as preparation and mailing of monthly statements; the cost of borrowing the funds to finance the customer's account; and the cost of bad debt. All of these costs are necessary to afford the consumer the convenience and flexibility which revolving credit offers.

The results of two studies conducted by the national accounting firm of Touche, Ross, Bailey & Smart confirm that for most retailers the cost of maintaining charge plans exceed any revenues derived from such plans.*/ These findings are

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*/ Touche, Ross, Bailey & Smart, Economic Characteristics of Department Store Credit, National Retail Merchants Association (1969); Touche, Ross, Bailey & Smart, Study of Consumer Credit Costs in Department Stores, National Retail Merchants Association (1963). The 1973 study, covering eleven department

[footnote continued on next page]

further confirmed by more recent studies.*/

Unless retailers can profitably extend credit, they will continue the current trend of abandoning their own credit plans and turning to third-party credit. This trend is not in consumers' best interests. Without the competitive pressure of retail operated credit plans there is less incentive for financial institutions to strive continually for the greatest efficiencies and lowest possible operating costs in their credit card plans.

Retailers deserve attention in terms of rate relief. They traditionally reach deeper into the universe of credit-worthy applicants than do other creditors. Because the retailer operates the in-house credit facility as an adjunct to the sale of goods and services, there is an incentive to extend credit

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[footnote continued from preceding page]

store chains and eighty stores, found that for the average active revolving charge account total credit costs exceed finance charge revenues ($13.64 in costs as compared to $11.82 in revenues) -- a deficiency amounting to approximately 1.3% of the value of total credit sales. The 1969 study found a deficiency of finance charge revenue as compared to the cost of administering a revolving account plan amounting to approximately 2.3% of credit sales, assuming an unrealistically low 6% cost of capital.

*/ Arthur Anderson & Co., Study of Finance Charges and Related Expenses of Revolving Credit Accounts of Four Connecticut Retailers, Connecticut Retail Merchants Association (1972); Dr. Roland Stucki, Utah Consumer Credit Report (1970); Ernst and Ernst, Retail Credit Operations Study (1971); Peat Marwick & Mitchell, Determination of Credit Revenue and Related Costs (1971); Retail Store Credit Card Use in New York, Shay and Dunkelberg in Cooperation with Touche, Ross & Co. (1973).

to the broadest possible range of creditworthy applicants. One study has revealed that more than twice as many consumers with an annual family income of under $15,000 used retail store charge accounts than used bank credit cards.*/

Another study which may explain this phenomenon indicated that retailers accept 75 percent of all credit applicants, as compared to an acceptance rate of about 50 percent for credit cards issued by financial institutions.**/ Therefore, retailers are concerned that increasing finance charge losses -- an inevitable result of continually increasing operating and financing costs coupled with ceilings on finance charge rates -- will eliminate them as an alternative source of credit for consumers. We oppose this trend toward further concentrating the credit-granting function in the hands of fewer creditors, because of the adverse consequences for merchants as well as for their customers. Higher charges and reduced diversification in the nature of the credit terms are the natural consequences of eliminating alternative sources of credit. NRMA is thus unalterably committed to promoting the widest possible variety of alternative sources of credit.

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*/ Lewis Mandell, Credit Card Use in the United States, U. of Mich. (1970).

**/ James F. Smith, Former Senior Economist, Federal Reserve Board, A summary of data drawn from a variety of sources, Quarterly Report of the Conference on Personal Finance Law, Winter 1976.

The National Commission on Consumer Finance analyzed retail credit and concluded that if revenues are not at least equal to the cost of extending credit, the following adverse consequences are likely: retailers will reduce the availability of credit by eliminating consumers (generally the higher risk consumers) from those to whom credit is extended; and cash customers will be forced to subsidize credit customers by virtue of necessary increases in cash prices to cover the deficiency between the costs of extending credit and revenues. The Commission specifically disapproved the notion of selecting any type of service provided by a retailer, including credit, and legally requiring it to be extended at a loss.

Retail sales are financed basically in two ways -- in-house credit extensions (via retailers' open end plans or closed end installment contracts) and/or third party credit (both open end and closed end credit). Unrealistic rate ceilings inhibit both types of financing. Thus, it is unnecessary to distinguish between the absence of profitability of in-house versus third-party financing for the purposes of this discussion. Both forms of financing have been demonstrated to be unprofitable and it serves no purpose to argue that restrictions in rates applicable to one type of creditor's extensions should be removed while restrictions on other creditors should remain. While the dynamics of the problem may differ in degree, the problem is the same. That is, the costs of extending credit exceed the revenues obtainable under the rates of most state laws.

In addition to the detriment to creditors, consumers are hurt by rate ceilings. When creditors cannot profitably extend credit, they stop altogether, as was the case with mortgage loans until recently, or they drastically reduce the availability of credit, illustrated by the recent lack of credit to finance automobile loans. This phenomenon has been demonstrated over and over, whether it is manifested in a particular locale, illustrated by the absence of consumer finance companies operating in the District of Columbia, or nationally, as in the case of the virtual cessation of lending by credit unions while the federal ceiling remained at 12%.

Another source of injury to consumers comes about by the subsidy of credit costs by those who pay cash, when finance charge revenues cannot sustain a credit program. In addition to reduced availability of credit, except to those who are the most affluent consumers, there is the inevitable increase in the cash price of goods by retail creditors to compensate for lost credit revenues. Thus, consumers who choose not to use credit or who cannot qualify for credit pay part of the cost incurred as the result of other consumers who do use credit. This simply is not a fair system of pricing. The key to fair prices for any commodity or service is competition among those who provide that commodity or service.

Consumer credit regulation is an emotional issue. It would be simplistic to equate the price of debt to the price of air travel. The regulation of consumer credit is an extremely

complex field involving the interplay of economic and social issues. It is important to emphasize, however, that supporting deregulation of the price of credit does not mean that all existing state law should be eliminated. To the contrary, there is a need to continue certain types of protections in the field of consumer credit,*/ just as deregulation in the field of air travel has not displaced the need for regulations to ensure air safety.

The National Commission on Consumer Finance**/ identified four reasons that are most often used to justify rate ceilings:

- o to redress unequal bargaining power;
- o to avoid overburdening consumers with excessive debts;
- o to administer credit grantors as public utilities; and
- o to assure that consumers pay fair rates for credit.

The Commission carefully analyzed each of these reasons to see if the current form of regulation fulfilled the goal. The Commission's conclusion bears repeating:

> ". . . the Commission must conclude that, on balance, rate ceilings are undesirable when markets are reasonably competitive. Imposition of rate ceilings on consumer credit transactions neither assures that most consumers will pay a fair price for the use of credit nor prevents overburdening

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*/ Regulation of certain collection remedies, disclosure of terms and costs, etc.

**/ Consumer Credit in the United States, Report of the National Commission on Consumer Finance, 1972, at p. 95.

> them with excessive debt. The public utility approach to rate making in the field of consumer credit is neither theoretically sound nor feasible although it can serve as a reminder that legislators must recognize the relationship between costs and credit sizes if they do set rate ceilings."*/

Most of the arguments used to support rate ceilings are predicated on a failure of competition to provide consumer credit at reasonable prices. Unequal bargaining power results from the inability of the consumer to take his or her business elsewhere. Thus, the public utilities are subjected to economic regulation because they are natural monopolies in which competition is impractical; we believe that a competitive market will determine what is a "fair" rate better than any statute or regulatory body can.

In sum, it is the position of NRMA that sufficient competition exists to nullify the reasons usually given for finance charge ceilings and that the side effects from the ceilings cause more harm than any benefits that might result. If that is the case, then rate ceilings should be abolished and a system of regulation relied upon that ensures that consumers are provided adequate information with which to make informed choices, which is already the case for all forms of credit subject to the Truth in Lending Act. This removal of rate ceilings would not affect other regulatory provisions that ban the discriminatory granting of credit, unfair collection

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*/ Consumer Credit in the United States, Report of the National Commission on Consumer Finance, 1972, at p. 108.

practices, and other aspects of the debtor/creditor relationship which are regulated. Its sole function would be to permit those who grant credit to charge the fair market value for the service.

STATEMENT OF THE

AMERICAN RETAIL FEDERATION

The American Retail Federation (ARF) is taking this opportunity to present for the record its views, comments, and suggestions regarding S.1406, the Credit Deregulation and Availability Act of 1981. ARF is grateful to the Committee and its staff for this opportunity to make known its views on this important legislation.

Membership in ARF consists of 33 national retail trade associations, 50 state retail associations, the Greater Washington Board of Trade, as well as corporate members. Through its members, ARF represents more than one million retail establishments.

The majority of retailers represented through the Federation offer or extend consumer credit in some form. For that reason, ARF is vitally interested in issues affecting the availability of consumer credit. Certainly, the matter of rate ceilings is one of the primary such issues. Thus, ARF is gratified at this opportunity to present its views.

In principle, ARF endorses with enthusiasm the purpose of S.1406. However, as explained more fully later in this statement, the Federation is opposed to the provisions of amended §512(b) and new §533(b)(1), both of which permit states to opt out of the federal preemption. Thus, ARF cannot support the bill as drafted.

Rate relief is absolutely essential to the continued economic health of the retail industry, because the laws of

most states currently impose unrealistically low ceilings on the rates of finance charge that can be assessed by retailers on consumer credit accounts. Those laws actually limit the maximum rates of finance charge to levels below the cost of the capital necessary to fund accounts receivable, and certainly below today's total credit operating costs. Said another way, the functional cost of extending retail consumer credit exceeds the credit revenues (i.e., finance charges) available under the laws of most states. And, retailers cannot make up that negative spread on volume.

Not only are the rate ceiling laws of most states fixed at uneconomic levels, but costs continue to rise. Labor, postage, and the cost of borrowed funds -- to say nothing of bad debt losses from personal bankruptcies -- are all important components of the cost of extending consumer credit, and they are all continuing to increase. If retailers are not able to offset these operating costs through realistic rates of finance charge, the inevitable result will be either a reduction in the availability of consumer credit, or a subsidization of credit through an increase in retail prices, or both.

If retail credit availability is reduced, it will undoubtedly be the lower income, less creditworthy consumers -- those who most need access to reasonable amounts of consumer credit -- who will suffer. If it becomes necessary to increase retail prices in order to subsidize credit losses, those

customers who pay cash, whether by choice or as a result of reduced credit availability, will be paying part of the freight for the credit customers. Neither result would be socially or economically desirable.

Quite aside from the social impact of credit rationing through artificial rate ceilings, the imposition of any statutory rate ceilings runs contrary to the other economic forces at work in the marketplace.

The retail industry is based on free, open, and vigorous competition. Every day, retailers compete on the bases of prices, quality and selection of merchandise, service, and an almost infinite array of other considerations that influence a consumer's decision to buy a particular product or service from a particular retailer. The actual cost of merchandise to the retailer, combined with competitive market conditions, determine the price at which that merchandise is offered for sale and the attendant services available with it. For example, the price of a 15 cubic foot refrigerator is based upon the cost of that refrigerator to the retailer and the competitive market conditions in which it is sold. It makes no economic sense at all, therefore, for artificial statutory restraints to fix the price for financing the purchase of that refrigerator, particularly in view of the fact that the cost of financing it is typically only a fraction of the cost of the refrigerator itself.

ARF urges that the cost of the credit service be subject to the same economic considerations involved in pricing the goods and other services sold: the cost to the supplier and competition in the market in which it is offered for sale. It is not sound economic policy to regulate the prices at which a service (i.e., credit) can be sold when the costs of that service continue to rise unabated.

In addition to the social, economic, and marketplace considerations involved in artificial rate ceilings, there is also the matter of practical operating problems. Unlike national banks, retailers are not permitted to impose finance charges on all customers based on the rate ceilings of the state in which they maintain their main offices. Thus, variations in rate ceilings from state to state impose significant operating burdens on retailers that operate across state lines. They must assess finance charges selectively on one of several alternative bases, such as the rate structure of the customer's state of residence or the rates permitted by the state in which the sale was made.

Retailers that have a significant customer base in several states must maintain operating procedures to classify customers or transactions by rate ceiling category and impose the respective rate or rates applicable to each category. The burden is even greater for retailers that have a substantial mail order operation. The essential fact is that it makes little economic sense -- and imposes significant economic

and operating burdens -- to have one credit office located, for example, in Dallas, billing customers in a five-state area under five different rate structures.

Accordingly, the American Retail Federation favors removal of all ceilings on rates of finance charge which may be imposed on extensions of consumer credit, thereby allowing natural market forces (including competition) to set market rates. We believe that the removal should be permanent and should apply to all rate ceilings, both state and federal.

In this connection, it is essential that Title I of S.1406 relating to business and agricultural credit be a part of any rate preemption package dealing with consumer credit. Otherwise, in mixed purpose credit extensions, a retailer would be faced with splitting an account balance and imposing state rate ceilings for business and agricultural credit on a part of the balance while the remainder of the balance remained free from any ceiling. This would be a significant problem; indeed, for the majority of retailers, it would be impossible.

For example, if a painting contractor came into the local department store and charged two tires for his pickup truck used in business, a pair of school shoes for his teenaged son, and a package of birdseed for his daughter's parakeets, the merchant would be faced with the task of imposing state rate ceilings for business credit on the balance applicable to the tires, while the remainder of the credit extension

would remain free of rate ceilings if Title II of S.1406 were enacted into law. Clearly, such a regulatory scheme would be unworkable.

Our principal objection to S.1406 is the authority of the states to opt out of the federal preemption within three years of the effective date of the Act. We see no sound economic or other reason to permit a balkanization of credit markets by selective reimposition of rate ceilings by state legislatures. After all, the major costs involved in extending and servicing consumer credit are uniform or nearly uniform nationwide.

For example, postage costs are absolutely uniform. The costs of capital, with minor variations by geographic region, tend toward uniformity; the prime rate in New York typically is the same as the prime rate in, say, Chicago, Houston, and San Francisco.

The costs of processing and billing equipment, whether rented or purchased, tend to be uniform, because the suppliers (e.g., Control Data, IBM, and Honeywell) are national companies with national prices. Even the cost of labor, although among the most variable of the cost components, is subject to a nationwide floor: the federal minimum wage which now stands at $3.35 per hour.

The essential fact is that the vast majority of costs involved in making consumer credit available are set by federal laws and/or regulations and by a national market that supplies

goods and services to retail credit departments.

Where there are variations in costs from region to region (e.g., prevailing wage rates), competition will tend to fashion rate structures that reflect these differences. For example, if prevailing wage rates and building occupancy costs are lower in region "A" than in region "B" and all other costs are uniform, competition in region "A" will tend to force rates down to reflect lower costs -- provided competition is allowed to work unfettered by artificial rate constraints.

Given the realities of our nationwide economy, ARF cannot support the provisions of amended §512(b) and new §533(b)(1) of S.1406 that permit states to reject the federal preemption. These provisions are an open invitation for the states to continue tinkering, essentially, with the availability of consumer credit. As noted earlier in this statement, differing rate ceilings from state to state impose economic and operational burdens on creditors (other than national banks), and the American Retail Federation cannot support any such measures.

ARF is grateful for the opportunity to present its views. The Federation will be delighted to cooperate with the Subcommittee or its staff in suggesting changes to implement our views.

American Ski Federation
499 South Capitol Street S.W.
Suite 406
Washington, D.C. 20003
202/484-6260

Representing the Interest of American Skiing

July 22, 1981

Senator John Tower
Chairman
Subcommittee on Financial
Institutions
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Tower:

On behalf of the American Ski Federation, I would like to commend you, Senator Lugar and your committee for its efforts on the development and thoughtful consideration of S. 1406, the Credit Deregulation and Availability Act of 1981. Attached is a statement from the American Ski Federation in support of S. 1406. I respectfully request that our statement be included in the hearing record of the recent hearings held before the Financial Institutions Subcommittee on S. 1406.

The American Ski Federation represents the interests of the U.S. ski industry. Our membership includes manufacturers and retailers of ski equipment and apparel and ski area operators. These three segments of our membership in particular are concerned about the negative impact that increasing unavailability of consumer credit is having and can have on the ski sport.

Thank you for your consideration of our request.

Sincerely yours,

Joseph T. Prendergast
President

JTP:te21

STATEMENT OF
THE AMERICAN SKI FEDERATION
IN SUPPORT OF S. 1406
JULY 22, 1981

The American Ski Federation (ASF) represents the interests of the ski industry. Our membership includes ski area operators, manufacturers and retailers of ski equipment and apparel, ski touring operators, professional ski instructors and the ski patrol system. Attached is a complete list and brief description of ASF member organizations.

ASF believes skiing is a healthy sport that contributes to the physical and mental well-being of its participants. Further, the ski sport is and can be enjoyed by a wide range of the American population.

The American Ski Federation is concerned about the negative impact that increasing unavailability of consumer credit is having and can have on the ski sport. Ski equipment and apparel purchases as well as certain costs of ski area visits are regularly financed by skiers using a credit card, most often a bank card, such as MasterCard or Visa. Bank card industry reports show that increasing numbers of banks, especially small local banks, are being forced to terminate or restrict bank card services in states that have usury ceilings and/or prohibit annual or transaction fees for bank card use.

Statement S. 1406
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Reduction in bank card services to consumers is detrimental to the U.S. ski industry which is now recouperating from two consecutive down seasons. Potential customers of U.S. ski retail shops must indefinitely postpone purchases until credit becomes more readily available. Retailers are thus unfairly hurt by credit restrictions imposed by state usury ceilings.

S. 1406 provides equitable solutions to difficulties posed by current state regulation of consumer credit. S. 1406 restores consumer credit to the dictates of a competitive free market system without interfering with consumer protection laws. In so doing, it eliminates unfair restrictions on retailers who depend on availability of consumer credit to Americans who choose to use it. For these reasons, the American Ski Federation supports S. 1406 and commends the subcommittee for its efforts in consideration of this legislation.

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RECEIVED SENATOR GARN

MOTORCYCLE INDUSTRY COUNCIL, INC.

AUG 8 12 00 AM '81

Government Relations Office

August 6, 1981

The Honorable Jake Garn
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

The Motorcycle Industry Council wishes to express wholehearted support for S. 1406, the "Credit Deregulation and Availability Act of 1981." The Council is a non-profit, national trade association that represents manufacturers and distributors of motorcycles and members of the motorcycle aftermarket.

S. 1406 would completely preempt all State usury ceilings on consumer credit and also eliminate the Federal ceiling that controls the rate of interest that can be charged by Federal credit unions. The bill would continue the precedent set by the Depository Institutions Deregulation Act of 1980 in the area of mortgage credit and thereby free up the market for all types of consumer credit transactions.

Unnecessarily restrictive State usury ceilings have prevented motorcycle dealers from arranging financing for thousands of prospective purchasers in recent months. In fact, credit limitations have become the greatest deterrent to sales in the motorcycle industry.

We hope that you will continue to support S. 1406 and that the bill will receive prompt Senate consideration.

Sincerely,

John F. Wetzel
Director
Federal Government Relations

cc Ms. Beth Climo

1001 Connecticut Ave., N.W., Suite 522 • Washington, D.C. 20036 • (202) 872-1381 • Telex 89-508

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Mortgage Bankers Association of America

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July 27, 1981

The Honorable John Tower
Chairman
Subcommittee on Financial Institutions
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Mortgage Bankers Association of America, the trade association representing this nation's mortgage banking industry, I should like to submit this statement regarding S 963, a bill to authorize loans at interest rates in excess of certain state usury ceilings, and S 1406, a bill to amend the Depository Institutions Deregulation and Monetary Control Act of 1980, and ask that it be made a part of the hearing record.

The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage banking companies
- Mortgage insurance companies
- Life insurance companies
- Commercial banks
- Mutual savings banks
- Savings and loan associations
- Pension funds
- Mortgage brokers
- Title companies
- State housing agencies
- Investment bankers
- Real estate investment trusts

The Honorable John Tower
July 27, 1981
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MBA supports governmental policies that deregulate artificial limits on interest rates, which impede the free flow of capital. All artificial limits of a similar nature should be cleared away. In this respect, we should like to point out two particularly troublesome problems that are beginning to impede the free flow of capital for home mortgage loans and will ultimately result in higher interest rates and a reduced availability of funds. The problems we refer to are the myriad of state laws restricting or prohibiting mortgage bankers, who are mortgagees approved by the Department of Housing and Urban Development (HUD), and state-chartered, federally insured depository institutions from offering the same types of adjustable-rate mortgages (ARMs) that federally chartered lenders are able to offer, and the state laws that prohibit or restrict the exercise of due-on-sale clauses in home mortgage loans.

The effect of these state laws is pervasive. Mortgage bankers, who are HUD-approved mortgagees, and state-chartered, federally insured depository institutions in some 26 states (see Exhibit I, attached), will not be able to offer the ARMs that federally chartered lenders will. As for due-on-sale, there are restrictive or prohibitive laws in 17 states (see Exhibit II, attached) that affect federally chartered commercial banks as well as the two groups of lenders listed above. Federally chartered lenders enjoy a preemption from state laws that otherwise would prohibit or restrict them from offering the full range of ARMs they are authorized to offer through the regulations issued by the Federal Home Loan Bank Board (FHLBB) and the Comptroller of the Currency. Federally chartered savings and loan associations also enjoy a preemption from state laws that prohibit or restrict the exercise of due-on-sale clauses in home mortgage loans.

These state law restrictions and prohibitions have a direct and detrimental effect on both the primary and secondary home mortgage markets, to the disadvantage of the home-buying public. Competition among lenders is and will be reduced, thus lessening the number of choices for consumers and reducing the availability of funds. Additionally, these restrictions will hamper the growth and vigor of the secondary mortgage market, which is vitally needed to tap non-traditional sources of mortgage capital in order to meet America's prospective housing finance needs.

The state law restrictions and prohibitions on exercise of due-on-sale clauses have already disrupted the secondary mortgage market. The two major institutional investors, the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) have altered their investment practices and procedures respecting loans originated in those 17 states listed in exhibit II. FNMA requires a seven-year "call provision" to be inserted in mortgages originated in those 17 states. FHLMC no longer accepts loans from states where the restrictions on due-on-sale are so severe that lenders may not even examine the creditworthiness of a third-party assumptor. These actions mark a significant, adverse change in the nationwide character of the secondary mortgage market and will seriously impact interstate commerce.

The disruption of the mortgage market caused by restrictions on the enforcement of due-on-sale clauses is demonstrated dramatically in the portion of the market served by FNMA. As mentioned earlier, FNMA requires a seven-year call provision in conventional mortgages from states with such restrictions. However, for mortgages originated by federally chartered savings and loan associations that have the protection of the FHLBB preemption, this requirement is waived. The result is that two lenders, with offices side-

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by-side on Main Street, both originating mortgages for sale to FNMA, and both competing for commitments in the same FNMA auction, cannot both offer prospective home buyers the same terms. The competitive inequity in such situations is obvious and works to the detriment of all potential home purchasers.

The same sort of side-by-side inequity will soon occur among lenders offering ARMs. Those favored with a preemption from state law will be able to offer the full panoply of ARMs, thus offering consumers the broadest possible choice. Those without a preemption will not. Ultimately, consumers will be the losers.

MBA has drafted proposed legislation (see Exhibit III, attached) that would remedy these inequities by allowing all lenders to offer the same array of mortgage loans. Quite simply, the proposed legislation would preempt state laws so that mortgage bankers, who are HUD-approved mortgagees, and state-chartered, federally insured depository institutions could offer ARMs that conform to regulations issued either by the Federal Home Loan Bank Board or the Comptroller of the Currency. In addition, the proposed law would preempt state laws that prohibit or restrict the exercise of due-on-sale clauses for those two groups of lenders and federally chartered commercial banks.

The proposed legislation would benefit the home buying public and assure vigorous competition in the primary and secondary mortgage markets so that America's home financing needs will be met. We respectfully urge your subcommittee to consider and act favorably upon legislation such as that which MBA has proposed.

Thank you for this opportunity to comment.

Sincerely,

Thomas T. Shealy

Thomas T. Shealy
President

TTS/dlt

EXHIBIT I

POTENTIAL PROBLEM AREAS FOR ADJUSTABLE RATE MORTGAGES
STATE-BY-STATE ANALYSIS

STATE	PROBLEM
CALIFORNIA	VRM statute imposes limitations. Poses problems for all state lenders with respect to federal regulations on ARMs.
COLORADO	Savings and loan statute provides that "no installments may be required which are larger than any prior installments."
GEORGIA	Statute may prohibit negative amortization.
HAWAII	Statute prohibits recovery of compound interest.
IDAHO	UCCC restrictions on balloon payments where interest rate exceeds 13 percent may cause potential problems with respect to SAMs.
ILLINOIS	Statute prohibits any change in the contract rate of interest during the term of a mortgage loan. Problems for all state lenders with VRMs, RRMs, and ROMs. In addition, old case law prohibits interest on interest. However, a state statute allows only state chartered S&Ls to offer GPMs and specifically exempts them from prohibitions on adding deferred interest to the principal.
INDIANA	VRM statutes impose restrictions for banks and savings and loans. Poses problems for state lenders with respect to federal regulations on ARMs and SAMs. UCCC restrictions on balloon payments would prohibit SAMs.
IOWA	VRM statute imposes restrictions. Poses problems with respect to federal regulations on ARMs.
KANSAS	Floating usury ceiling in effect.
MARYLAND	Possible regulatory restrictions for S&Ls on VRMs and ROMs.
MASSACHUSETTS	Possible regulatory restrictions with respect to VRMs and RRMs.
MICHIGAN	Statute prohibits increases in initially effective interest rate.
MINNESOTA	Statute prohibits raising interest rate during the term of the loan.

Exhibit I

STATE	PROBLEM
MONTANA	Interest on interest may be prohibited by old case law.
NEVADA	Old case law may prohibit interest on interest.
NORTH DAKOTA	State statute requires all contracts to bear same rate of interest after maturity as they bear before maturity. Potential problem with respect to RRMs and ROMs. In addition, statutory law may prohibit interest on interest.
PENNSYLVANIA	VRM statute imposes limitations.
RHODE ISLAND	Statute requires that loans with certain loan-to-value ratios must provide for monthly payments of principal and interest in substantially equal amounts.
SOUTH CAROLINA	VRMs prohibited on loans under $100,000.
TENNESSEE	VRM statute imposes potential restrictions.
TEXAS	Possible regulatory restrictions for S&Ls on VRMs.
VERMONT	Possible regulatory restrictions for banks and S&Ls with respect to VRMs.
VIRGINIA	Statute prohibiting non-ascertainable interest rate not pre-empted by federal usury statute.
WEST VIRGINIA	Interest rate increase in mortgage contract prohibited by statute. Old case law prohibits interest on interest.
WISCONSIN	VRM statue imposes limitations.
WYOMING	UCCC restrictions on balloon payments may preclude SAMs.

ABBREVIATIONS

VRM	Variable rate mortgage
ARM	Adjustable rate mortgage
UCCC	Uniform Consumer Credit Code
SAM	Shared appreciation mortgage

RRM	Renegotiable rate mortgage
ROM	Roll-over mortgage
S&L	Savings and loan association
GPM	Graduated payment mortgage

Source: Mortgage Bankers Association of America, July 1981

Exhibit II

STATES WHERE THE EXERCISE OF DUE-ON-SALE CLAUSES IS PROHIBITED OR RESTRICTED

Arkansas
Arizona
California
Colorado
Florida
Georgia
Illinois
Iowa
Michigan
Minnesota
Mississippi
New Mexico
New York
Ohio
Oklahoma
South Carolina
Washington

Source: Mortgage Bankers Association of America, July 1981

Exhibit III

NATIONWIDE SECONDARY MARKET ACT OF 1981

An Act to strengthen the nationwide secondary market in home mortgage loans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Nationwide Secondary Market Act of 1981."

FINDINGS AND PURPOSE

SECTION 2. Congress finds that—

(1) demand for housing during the decade of the 1980s is expected to be the greatest in U.S. history;

(2) rapid increases in mortgage interest rates are reducing capital sources for long term, fixed rate home mortgage loans for homebuyers;

(3) in order to continue to make home mortgage loans available, lenders are exercising due on sale clauses in existing mortgages upon the transfer or sale of the residences securing the mortgages, and are beginning to offer mortgage loans with adjustable interest rates and renegotiable terms where state and federal laws and regulations permit. However, a number of states prohibit or restrict the exercise of due on sale clauses in existing mortgages upon the transfer or sale of the residences securing the mortgages and some state laws, designed for other purposes, prevent lenders from providing loans in the form of adjustable mortgage loans;

(4) in response to these changes in the home mortgage loan market, the Federal Home Loan Bank Board, and the Comptroller of the Currency, have promulgated regulations authorizing federally chartered savings and loan associations, and national banks respectively to make or purchase adjustable rate mortgage loans regardless of state laws that would otherwise interfere. These regulations contain consumer safeguards, along with provisions for uniformity. The Federal Home Loan Bank Board has also promulgated regulations that permit federally chartered

savings and loans associations to exercise due on sale clauses in home mortgages despite state laws to the contrary;

(5) adjustable rate mortgage loans, and exercise of due on sale clauses in existing loans, will assist lenders to meet the home mortgage loan requirements for expected housing demand by allowing lenders to adjust to rapidly increasing costs due to inflation. However, this housing demand is expected to be so great that a strong active and national secondary market for all types of mortgage loans will be needed to attract a variety of investors with sufficient capital to meet the need;

(6) two groups of lenders who are significant participants in the secondary mortgage market, and who could be expected to be significant sources of home mortgage finance, are not included in the adjustable mortgage loan, state law preemptions of the Federal Home Loan Bank Board and the Comptroller of the Currency. These are lenders approved by the Secretary of the Department of Housing and Urban Development for participation in any of the mortgage insurance programs under the National Housing Act, and state chartered lending institutions. In several states due to state law restrictions, these lenders are prevented from offering adjustable rate mortgage loans similar to those authorized for federally chartered savings and loan associations, and national banks;

(7) in addition, these two groups of lenders together with federally chartered commercial banks, are not included in the due on sale, state law preemption of the Federal Home Loan Bank Board. As a result, major secondary market investors have changed their investment procedure with respect to loans purchased from these lenders that are not covered by the Federal Home Loan Bank Board preemption and are located in states where the exercise of due on sale clauses is prohibited or restricted by operation of state laws;

(8) the exclusion of these groups of lenders from the adjustable mortgage loan and due on sale preemptions is detrimental to the home buying public in a significant number of states because there will be fewer sources of home mortgage loans. This reduction in competition among lenders, both in the primary and secondary markets, may result in increased costs and reduced mortgage availability for homebuyers and less liquidity in the secondary mortgage market; and

(9) therefore, in order to permit the continuing development of strong and active primary and secondary markets in all types of home mortgage loans so as to provide sufficient capital for mortgage loans to home buyers at a reasonable cost, Congress finds it necessary and desirable to preempt state laws that prevent lenders from: (a) making or originating an adjustable rate mortgage loan in conformity with regulations promulgated by the Comptroller of the Currency or the Federal Home Bank Board; and (b) from exercising due on sale clauses in home mortgage loans.

DEFINITIONS

SECTION 3. As used in this Act—

(1) the term "Adjustable Rate Mortgage Loan" means any mortgage loan that does not carry a fixed interest rate, or a fixed schedule of payments, or does not amortize each year of the entire term of the loan or mortgage.

(2) the term "Qualified Lender" means—

(A) any lender approved by the Secretary of the Department of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act;

(B) any state bank as defined in Section 3(a) of the Federal Deposit Insurance Act (12 USC 1813(a));

(C) any mutual savings bank as defined in Section 3(f) of the Federal Deposit Insurance Act (12 USC 1813(f));

(D) any savings bank as defined in Section 3(g) of the Federal Deposit Insurance Act (12 USC 1813(g)); and

(E) any building and loan, savings and loan, homestead association, or co-operative bank organized and operated according to the laws of the State, District, Territory or possession in which they are chartered or organized and whose accounts are insured pursuant to Title IV of the National Housing Act (12 USC 1730).

(3) the term "Due on Sale Clause" means a provision in a home mortgage loan that permits a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the real property securing the home mortgage loan is sold or transferred by the borrower without the lender's prior written consent.

(4) the term "State" includes the several States, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the Trust Territories of the Pacific Islands, the Northern Marianas Islands, and the Virgin Islands.

MAKING OR PURCHASING ADJUSTABLE MORTGAGE LOANS AND EXERCISE OF DUE ON SALE CLAUSES

SECTION 4. Without regard to any limitations that otherwise would be imposed on such a lender by the constitution, statutes, court decrees, common law, rule, and public policies of any states, a qualified lender may:

(1) make or purchase home mortgage loans in conformity with regulations promulgated by the Comptroller of the Currency that establish rules for national banks making or purchasing adjustable rate mortgage loans or in conformity with regulations promulgated by the Federal Home Loan Bank Board that establish rules for federally chartered savings and loan associations making or purchasing adjustable rate mortgage loans; and

(2) exercise due on sale clauses contained in new and existing home mortgage loans;

SECTION 5. The provisions contained in Section 4(2) of this act shall apply to any insured bank as defined in Section 3 of the Federal Deposit Insurance Act (12 USC 1813).

INTERPRETATIONS

SECTION 6. The Federal Home Loan Bank Board is authorized to issue rules and regulations and to issue interpretations governing the implementation of this Act.

WITKOWSKI, WEINER, MCCAFFREY AND BRODSKY, P. C.

ATTORNEYS AT LAW

SUITE 350

1575 EYE STREET, N. W

WASHINGTON, D. C. 20005

(202) 628-2000

SANFORD A. WITKOWSKI
HARVEY E. WEINER
R. LAWRENCE MCCAFFREY, JR.
JAMES A. BRODSKY
D. EDWIN SCHMELZER

RICHARD I. PETETER
PETER A. GILBERTSON
FELICIA A. ALTMEYER
ARTHUR B. AXELSON*

*ADMITTED IN MD. ONLY

GEORGE J. LEIBOWITZ
COUNSEL

August 20, 1981

The Honorable John Tower
Chairman
Subcommittee on Financial Institutions
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Task Force on Creative Finance for Manufactured Housing, we are pleased to submit this written statement regarding the Credit Deregulation and Availability Act of 1981 (S.1406).

The Task Force on Creative Finance for Manufactured Housing was established four months ago by members of the manufactured housing and finance industries. Manufacturers, retailers and creditors all are represented. The Task Force was formed because of concern on the part of the member companies that there would be a severe shortage of funds for the financing of manufactured homes if innovative finance programs of the type currently being developed for traditional single-family housing were unavailable for the manufactured housing product. The members of the Task Force consider adjustable rate loan instruments to be the key form of innovative finance for meeting the needs of the manufactured housing industry. The goal of the Task Force is not only to have ARM loan programs created for manufactured housing, but also to have sufficient uniformity established within the market to facilitate the development of an active secondary market in adjustable rate loan instruments for manufactured homes. The Task Force believes that in order to achieve this uniformity and to open additional sources of financing through new and expanded secondary markets, Congressional action is needed.

Manufactured housing comprises a substantial segment of new home sales each year. Manufactured home sales currently account for approximately 23 percent of all new home sales, and in many parts of the country this form of housing supplies the only form

of affordable home ownership. Congress increasingly has recognized the benefits of manufactured housing, as demonstrated by the steps it took to ensure that all such homes conform to a single, uniform construction and safety code (the National Mobile Home Construction and Safety Standards Act of 1974). Since enacting that landmark legislation, Congress steadily has expanded the range of subsidy and loan insurance programs available to manufactured housing in home ownership situations.

The Task Force has begun both to analyze federal and state statutes and regulations to identify the existing limitations which prevent the achievement of its objectives and to devise the remedies to overcome identified limitations. In this effort, restrictions on adjustable rate transactions, made as either direct loans or installment sales, and secured by either personal property or mixed personal and real property, will be addressed. Special problems relating to any one particular type of lender also will be addressed.

Our survey (copy attached) is being undertaken by the legal departments of companies which are members of the Task Force. Examples of the types of questions which are contained in our survey include:

- Does the state law governing manufactured home loans or credit sales address adjustable rate transactions?
- Has the Federal usury preemption been overridden in the state? If so, what usury provisions govern manufactured home loans?
- Does state law require substantially equal payments?
- Are balloon payments prohibited?
- Can the rate of amortization be adjusted during the loan term?
- Under what conditions and with what limitations are "due on sale" clauses enforceable?

Each question is intended to be answered for the various types of manufactured home credit transactions (e.g., a credit sale

financing of a home only, or a combination manufactured home and lot transaction involving a credit sale and/or a direct mortgage loan or a land sales contract) made by different categories of creditors (e.g., finance companies, state-chartered institutions, etc.). The survey covers the 30 states to which approximately 92 percent of all manufactured homes were shipped in 1980.

While the Task Force has not yet completed its detailed state law survey, it is apparent from our work to date that there are restrictive laws in a large number of states that hamper mortgage bankers, finance companies, and state-chartered banks and savings and loan associations from originating or purchasing adjustable rate mortgage instruments.

Typical of the state laws that impede the development of adjustable rate transactions for manufactured housing are state laws which contain: a requirement for substantially equal monthly payments; a prohibition against balloon payments; a requirement that that the loan be fully amortized within its original term without extension; a prohibition against charging interest on interest or against negative amortization; and a variety of complex and inconsistent disclosure and notice requirements which often were designed without contemplation of adjustable rate transactions. Such state laws may prove to be a serious impediment to adjustable rate mortgages on real estate. This potential problem would be further exacerbated for manufactured housing due to the peculiar treatment this type of housing is accorded under state law. Manufactured home loans and credit sales may come under entirely different state law provisions, depending upon whether the home is treated as personal property or real propery under state law (or a mixture of the two where the home is financed in combination with land), or whether the home purchase loan is a direct loan or a credit sale.

The Comptroller of the Currency, the Federal Home Loan Bank Board and the National Credit Union Adminstration all have implemented adjustable rate mortgage programs for all-real- and personal property manufactured home loans originated or purchased by national banks, federal savings and loan associations and federal credit unions, respectively. Each of these programs contains a strong statement of Federal preemption of all state laws that would in any way restrict, limit or impede the governed institution from making, purchasing or participating in adjustable rate transactions.

As noted above, each of the three agency adjustable rate instrument programs specifically includes loans for the purchase of mobile/manufactured homes. The Comptroller of the Currency's ARM program defines an adjustable rate mortgage loan to include any loan to finance or refinance the purchase of a one- to four-family dwelling, including a condominium unit, a cooperative housing unit or a mobile home (12 C.F.R. §29.2). Mobile homes are eligible for inclusion in the Bank Board's adjustable rate mortgage loan program by way of regulation 12 C.F.R. §545.7-6(e)(2)(iii), which authorizes federal savings and loan associations to make loans that comply with the provisions of 12 C.F.R. §545.6-4 or 4a (the ARM regulations). The National Credit Union Administration recently amended its consumer lending policy regulations (12 C.F.R. §701.21-1 and 2) to permit interest rates and amortization schedules on all consumer loans (including mobile homes loans) to vary in accordance with policies prescribed by a credit union's board of directors. Thus, the three categories of federally chartered institutions have distinct competitive advantages over many state-chartered institutions, mortgage bankers and finance companies which do not benefit from a similar preemption of state laws. We believe that this advantage is inequitable.

The two major national secondary mortgage market institutions, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, both have announced new programs for purchasing adjustable rate mortgage instruments. As we understand the programs, all-real-property combination manufactured home and lot loans would be eligible for purchase under these programs. However, data from studies completed by other groups show that nonfederally chartered lenders could not make such adjustable rate transactions in approximately twenty-six states. Therefore, nonfederally chartered institutions are denied this important secondary market opportunity to improve their liquidity by selling adjustable rate all-real-property manufactured home loans in these secondary market programs. (Neither the FNMA nor the FHLMC program covers manufactured home only loans.)

When it began its state law research, the Task Force was, and remains, quite prepared to undertake the project of seeking change in state laws from within each state. It now has become apparent, however, that the scope of this problem is so enormous as to involve at least one-half of the states. The project of working to amend the laws in so many states probably would be

too costly and time consuming for the Task Force to undertake and in any case would create substantial delay in the implementation of adjustable rate loan programs. The Task Force recognizes that as a result of recent statutory and regulatory changes, and particularly in today's economic climate, only limited funds are available for housing finance. The Task Force members further recognize that manufactured homes must compete with traditional site-built homes for their share of this limited pool of funds. In order to compete for these funds and attract secondary market investors, manufactured home loans, whether secured by real or personal property, must be offered with terms similar to those used in traditional site-built home lending, taking into account the historic differences in the nature of the transactions. It has become necessary, therefore, for us to appeal to the Congress to take immediate action that would permit any category of creditor, whether federally chartered, state-chartered, or a mortgage or finance company licensed under state law, to originate, purchase or participate in adjustable rate home purchase transactions for real estate and personal property manufactured home loans.

It is critical that action be taken now. Even if interest rates were to drop, creditor and investor uncertainty regarding future economic conditions still would require an adjustable rate instrument; credit would be cut off to manufactured housing if creditors believed that interest rates would again rise and creditors were limited to using fixed rate instruments. Furthermore, we believe that it would be very difficult to muster Congressional or state legislative support for ARM legislation at a time of lower interest rates, even if credit clearly were being denied to this important sector of the housing market.

Accordingly, the Task Force recommends that your Subcommittee include, either as a part of S.1406, or as companion legislation to S.1406, a provision to preempt state laws or constitutional provisions that limit, restrict or impede the use of adjustable rate instruments for manufactured home transactions, whether the home be personal property or real property, and whether the credit transaction be a direct loan or credit sale. Such action would create parity between the nonfederally chartered creditors, such as mortgage bankers, finance companies and state-chartered lending institutions, and the federally chartered banks, savings and loan associations and credit unions.

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WITKOWSKI, WEINER, MCCAFFREY AND BRODSKY, P.C.

The Honorable John Tower -6- August 20, 1981

During the past few years, high inflation and volatile interest rates have created a need for Federal regulatory agencies not only to grant authority for their regulated institutions to use adjustable rate instruments, but in addition to preempt all state laws hindering the use of such instruments. These same conditions of inflation and high interest rate also have created the need for federally preemptive legislation to grant the same authority to nonfederally chartered lending institutions.

The Task Force on Creative Finance for Manufactured Housing thanks you for this opportunity to present its views.

Sincerely,

Harvey E. Weiner
Washington Counsel

HEW/sos
8564A/81-551

June 11, 1981

State Survey - Adjustable Rate Transactions

Instructions:

1. For background information regarding the development of these questions, please refer to Newsletter 81-3.

2. Please note that we use the term "adjustable rate transaction" to include both renegotiable rate and variable rate transactions as well as the combinations and permutations of each type. Graduated payment transactions are outside the scope of this research inquiry.

3. Each question should be answered for each type of transaction described below except where you determine that a question is not applicable to one or more of the types of transactions, in which case responses should be provided only for the appropriate type(s) of transaction(s). The four types of transactions are:

1. a credit sale financing of a mobile home only;

2. a combination mobile home and land financing where a credit sale or land installment sales contract is involved;

3. a combination mobile home and land financing where no credit sale is involved (direct loans); and

4. financing of a mobile home only with a direct loan.

(Note that transaction types 2 and 3 could have been further subdivided (i.e., transaction 2(a) could have addressed homes financed with credit sale and land sale combinations while 2(b) could have addressed credit sale and direct loan combinations). We have chosen not to refine the transaction types further, however, in order to limit somewhat the scope of the research effort. Nevertheless, we would appreciate a report on any differences or peculiarities (affecting adjustable rate financing) you become aware of among subcategories of transaction types 2 and 3.)

3. Please be certain to provide us with accurate citations both to the act(s), such as Motor Vehicle or Retail Installment Sales Act, and to the specific sections within the act(s). It also would be helpful if you would forward us copies of the relevant provisions where feasible.

4. After we have obtained your responses in narrative form, we plan to prepare a comparative chart which highlights key elements of the survey. We would appreciate your suggestions and comments as to both the format and specific content of such a chart.

5. Please forward your responses to the survey to us by no later than close of business on August 1, 1981.

Questions

1. What state law(s) governs the manufactured housing loan or credit sale transaction? Please cite.

2. What are the relevant sections of the law(s)?

3. Does the law(s) specifically address adjustable rate transactions? If so, please cite and describe in detail (e.g., is there a specified index that must be used for the rate adjustment; is negative amortization permitted; must the same terms as were contained in the original loan or credit sale be reoffered upon renegotiation of the transaction; can there be an extension of the loan term; are there special required disclosures and/or notices, etc.?).

4. The Federal Usury Preemption, as provided by Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980, has been overridden in some form in nine states and the Commonwealth of Puerto Rico. Three of these states (South Carolina, Kansas, and Colorado) are among the thirty states to be analyzed by this study. We have not reviewed any of these state laws to determine whether they specifically override the usury preemption for mobile home loans. Therefore, in these three states, the assigned companies should analyze the usury override legislation carefully to determine whether the Title V usury preemption for mobile homes has been overridden. If it has been, please describe the mobile home usury provisions contained in the new statute. In the other 27 states, please determine whether legislation to override the usury preemption for mobile homes is currently under consideration. If so, please describe the legislation, and report on its status.

(Questions 5 through 14 are for states without specific statutory adjustable rate transaction provisions)

5. In the assigned state, is the time-price doctrine in effect? If the doctrine does exist, must the credit sale be precomputed, or may it be interest bearing? If it does not exist, does the state law permit both interest-bearing and precomputed rate transactions?

6. If the adjustable rate transaction is a precomputed credit sale, will the transaction be deemed to be a refinancing requiring a new contract and possibly new disclosures at the point that the rate is modified? Also, if deemed to be a refinancing, will it be found to involve the imposition of "interest on interest" and/or prohibited balloon payments? Would any of these characterizations affect the lien priority? In the event the transaction is recharacterized as a refinancing, is there any state law provision requiring that, upon renegotiation, the same terms be offered as were contained in the original credit sale? In light of these potential problems, please give us your thoughts as to whether the transaction would be more palatable as a "renegotiable rate" transaction (i.e., long-term amortization with a short-term note guaranteed to be refinanced at a negotiated rate) as opposed to a "variable rate" transaction (i.e., a long-term amortization and long-term note with a floating interest rate)?

7. Theoretically, would the existence of adjustable rate authorization undermine arguments for retaining the time-price doctrine? Does the very introduction of adjustable rate instruments so interfere with the dichotomy of loan versus credit sale that we could be causing problems that would exceed the benefits to be derived from authorizing such adjustable rate transactions?

8. Does state law contain a provision requiring substantially equal payments? Please describe.

9. Does state law contain a prohibition against balloon payments? Please describe.

10. Can the rate of amortization be adjusted during the loan or credit sale term? Can there be an extension of the term? Is negative amortization, i.e., compounding of interest or charging of interest on interest, permitted?

11. Are there any notice and/or disclosure requirements under state law that may interfere with, or impede, the making of an adjustable rate loan or credit sale on a mobile home? Does the absence of an adjustable rate disclosure provision create a problem which could limit a creditor's ability to make an adjustable rate loan or credit sale on a mobile home?

12. For direct loans, are prepayment penalties permitted? In the case of credit sales, are points, origination fees and acquisition fees permitted to be considered earned when paid?

13. Does state law prohibit or limit the collection of points at the time of renegotiation of the rate under a renegotiable rate transaction?

14. Under what conditions and with what limitations are "due-on-sale" clauses enforceable? Can an assumption fee be imposed? Explain.

(Questions 15 through 19 apply to all states)

15. What do state regulators and other officials consider to be the major problems with adjustable rate transactions for mobile homes? What other thoughts or comments do they have regarding such transactions?

16. Recognizing that states generally have particular laws or special provisions applying to different types of creditors, such as state-chartered banks and savings and loan associations, mortgage bankers and finance companies, are there any additional or special problems (that remain unresolved by usury preemption) for any type or types of creditors? If so, please explain.

17. In general, what do you consider to be the major obstacles (whether listed above or not) to establishing an adjustable rate program for mobile homes in your assigned state?

18. What other practices, court decisions or regulations are you aware of that may have some impact on the making of adjustable rate loans or credit sales in your assigned state?

19. In your assigned state, under what circumstances, if at all, can a combination mobile home and lot transaction be "all real property" (for purposes of both taxation and lien security)?

Statement in support of S1406 - Credit Deregulation and Availability Act of 1981

A Bill to amend the Depository Institutions Deregulation and Monet.ary Control Act of 1980.

Prepared by Barbara Keating-Edh, President CONSUMER ALERT

The CONSUMER ALERT organization appreciates this invitation to voice its support for S1406 the Credit Deregulation and Availability Act of 1981.

Those who are fully aware of our nation's economic woes can only enthusiastically applaud this Administration's and this Senate's efforts to bring inflation under control and we of CONSUMER ALERT are optimistic about efforts to reduce the scope of federal government.

Informed citizens are willing to forego the temptations of shortsighted, immediate, advantages in order to seek the long range goals that will bring economic health and wealth to our land once again.

CONSUMER ALERT is a nationwide not-for-profit membership organization headquartered in Modesto CA. It's dues-paying members evaluate issues of concern to the consuming public and are kept informed through a regular newsletter. We have found beyond a doubt that our enterprise system, if allowed to function free of excessive intervention by government, offers consumers the broadest range of products and services at competing prices. Money is no exception.

We are aware of repeated examples of where price-ceilings have retarded supply. Most recently we have noted shortage of oil and climbing gasoline prices. When prices are held artificially low by government, two things happen.... demand increases and suppliers find it less profitable, resulting in a reduced supply. Whether or not some groups and individuals wish to deny these market factors, reality clearly shows this to be the case.

CONSUMER ALERT ON S1406

Consumers need money to purchase their automobiles, to purchase and improve their homes and to buy a variety of big tag consumer products. Small businessmen and farmers too are equally dependent on the availability of capital in order to function productively. The Depository Institutions Deregulation and Monetary Control Act of 1980 was congressional recognition that ceilings on lending rates was reducing the availability of mortgage loans and capital needed to build housing for consumers.

This present attempt to amend that Act will further the cause begun by Congress last year, that of freeing up money available for credit to consumers. It is a national issue. Under passage of this Bill each State would be given complete freedom to decide the issue of usury ceilings for itself. In fact, such federal action would force States to consider the cost of credit transaction's effect on statewide economy. As it presently stands, consumers in some States are subsidizing borrowers in other States.

Under present restrictive ceilings savings and loans have refrained from consumer lending when consumers and small businesses are anxiously looking for places to borrow short-term.

Of those consumer 'advocates' who believe that ceilings on credit should remain we are distressed that they continue to embrace the mistaken notion that lids protect consumers. They fail to tear loose from the faulty premise that controls lead to less. Advocates who are sincere should not turn their backs on availability, an extremely important consumer need.

Borrowing money is an obvious service for which consumers are willing to pay. Naturally, we are concerned about climbing interest rates but what concerns us even more is, not enough or no money available for borrowing, and that is what happens when government puts ceiling squeezes on the institutions which loan consumers the capital we seek.

It is our conclusion that equity will ultimately result

from free-wheeling negotiable lending. Competition in the extension of credit will ensure that consumers can benefit from the advantageous competitive situations that would result. As it stands now consumers are victims of government controls and they are denied the opportunity to enter in the negotiation of credit.

There is one other consideration. In many cases the usury laws in existence simply stimulate the inventiveness of people who must seek "loop-holes" or otherwise find ways to provide or secure the credit they need to keep their businesses going or going to make the purchases they want. This is just one more instance where people are driven to a disrespect for their government. Additionally, such efforts are costly, often involving litigation, legal costs, all of which builds additional unproductive overhead into the cost of the lending business.

In any event the Bill introduced here by Senators Lugar, D'Amato and Proxmire would draw back federal involvement and allow decisions concerning consumer credit to be made at the State level. Some of those States will undoubtedly reimpose their own ceilings. But at least those States would have first been required to listen and encourage the views of their residents concerning credit transaction costs.

CONSUMER ALERT feels moving government decisions closer to the people directly affected is advantageous to individual citizens.

This amend.ment really does not intrude in State actions. In fact it encourages State action. States will still determine decisions concerning standards of supervision, consumer protection and liscensing. If some States decide to continue their present usury ceilings or even tighten up credit, that would be their prerogative. In fact this then would enable us to see precisely what happens under ceilings vs. negotiable credit interest levels. Ultimately, we are confident that such comparisons would clearly

show that States which impose ceilings in an effort to 'aid' consumers would have denied their residents easy availability of credit..while loans at higher and somewhat flexible interest rates were readily available in those States which opted for the de-regulation route. With these results clearly evident, the next move State by State would be freeing-up credit for all consumers in a more equitable manner nationwide.

We urge Congress to pass S1406 as submitted for consideration by Senators Lugar, D'Amato and Proxmire thereby abiding by the wishes of the electorate. Consumers are willing to take their chances and seize the opportunities that can only be afforded them by free market competition.

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF THE CHAIRMAN

July 22, 1981

Honorable John Tower
Chairman
Subcommittee on Financial Institutions
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Tower:

Thank you for your letter of July 11, 1981 extending an invitation to testify on two bills (S. 963 and S. 1406) to preempt state usury laws.

The Commission commented on this issue in hearings held before the Senate Banking Committee on May 16, 1981 and in a subsequent letter to Senator Richard Lugar commenting on H.R. 2501, a bill to deregulate the interest rate on business and agricultural loans and consumer credit. Since these statements set forth the Commission's position on this issue, we are, after consulting with your staff, providing them for the record in lieu of testimony. In addition, I have requested the staff to review the legislation referenced in your letter to determine whether any further comments are appropriate.

We, of course, are available to respond to any questions which you or the Committee staff may have on our prior statements.

I hope that you will find the attached information helpful in your review of this proposed legislation.

Sincerely,

David A. Clanton
Acting Chairman

STATEMENT

OF

LINDA COLVARD DORIAN

DEPUTY DIRECTOR

BUREAU OF CONSUMER PROTECTION

FEDERAL TRADE COMMISSION

I am pleased to appear before you today to present the views of the Federal Trade Commission on the subject of Federal regulation of consumer financial services.

As wide-ranging changes continue to occur in the country's financial markets, there is a growing need to assess the effects of consumer financial services regulation. The Commission shares this Committee's desire to ensure that existing and proposed legislation and regulations do not stifle competition in the markets for consumer financial services. At the same time, we believe that the movement toward simplification and deregulation should not, and need not, result in the erosion of important protections for consumers.

As you know, the Commission is charged with the responsibility for enforcing various provisions of the Federal Consumer Credit Protection Act. More specifically, the Commission enforces the Truth in Lending, Fair Credit Billing, Equal Credit Opportunity and Consumer Leasing Acts with respect to most creditors other than those under the jurisdiction of the bank regulatory agencies. In addition, the Commission enforces both the Fair Credit Reporting Act and the Fair Debt Collection Practices Act with respect to most credit bureaus and debt collectors, and has limited enforcement responsibility under the Electronic Fund Transfer Act.

In general, the Commission believes that most of the statutes it administers have worked well. Nevertheless, we are aware of a number of areas in which these laws can be improved, to the benefit of both consumers and creditors. These hearings may call other potential improvements to this Committee's attention as well.

In addition to administering these consumer protection laws, the Commission has important responsibilities for ensuring fair competition in the marketplace. We recognize that regulations affecting the markets for consumer financial services can have a differential impact on different classes of creditors, thus skewing the competitive process. For example, as other witnesses may point out, the point-of-sale documentation requirements of the Electronic Fund Transfer Act could, absent some regulatory or legislative exception, inhibit the development of in-home banking by cable television operators.[1] Similarly, the disparity in permissible rates of charge among different types of financial institutions and other creditors necessarily provides some suppliers of credit a competitive advantage over others.

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1 Provision of in-home banking services by telephone already has a legislative exception from the point-of-sale documentation requirements.

Thus, we support the efforts of this Committee to review the competitive effects of existing regulations in connection with the ongoing deregulation of financial services. We also believe, however, that the protections afforded consumers by various statutes enacted over the past ten years should not lightly be displaced. In many instances, we think this Committee may find that a fine-tuning of the statutes will correct competitive imbalances without sacrificing essential consumer protections.

I will turn now to a discussion of several subjects that may be of particular concern to this Committee.

1. Further Simplification of the Truth in Lending Act

Like the Federal Reserve Board, we believe that there are some areas in which the process of further change may impose burdens that are greater than the benefits obtained. One such area is Truth in Lending. The Truth in Lending Act has long been the focal point of concern about overly detailed, technically complex regulation of creditors in the name of consumer protection. In response, Congress adopted the Truth in Lending Simplification Act of 1980, and the Federal Reserve Board staff has recently completed a thorough revision of

Regulation Z, which implements the Act. While creditors may begin complying with these revisions at any time, the amendments will not become fully effective until April 1982.

The Federal Reserve Board and its staff have done a commendable job in trying to simplify Regulation Z, even in areas not specifically changed by the Simplification Act. Not only have the overall length of the regulation been reduced and model forms been provided, but many of the troublesome problems of statutory construction which caused litigation in the past have been resolved. In addition, the Act itself made substantial changes in the civil liability imposed on creditors.

We would recommend that the Congress wait until more experience has been gained under the simplified regulation and altered civil liability provisions before initiating new changes. In the interim, we think the Board will be able to help small creditors to comply with the new law by developing additional model forms under §605 of the Simplification Act. We believe that such forms offer the best means of reducing both the compliance burden and exposure to civil liability imposed by the Act. The Board staff has already made some model forms available. We believe the experience of small creditors in attempting to use these forms during the present implementation period will be useful to the Board staff in determining whether additional or more specialized forms are needed.

2. Other Areas of Possible Simplification

There are several areas in which simplification of existing law could benefit both consumers and creditors. These include integration of the Equal Credit Opportunity Act's reason for denial provisions with the Fair Credit Reporting Act notice of adverse action provisions, and simplification of the procedures for filing billing disputes under the Fair Credit Billing Act.

A. Integration of the Equal Credit Opportunity Act's Reason for Denial Provision with the Fair Credit Reporting Act Notice of Adverse Action Provision.

The Fair Credit Reporting Act currently requires that any consumer who is denied credit, or for whom the cost of credit is increased, based on information contained in a credit report, must automatically be told the name and address of the credit bureau from which the information was obtained. Similar provisions apply when credit is denied based on information supplied by third parties other than a credit bureau.

The ECOA, on the other hand, requires that consumers be given specific reasons for adverse action in instances in which they are denied credit, but not in most instances in which the cost of credit is increased. Moreover, the ECOA's adverse action notices need be given only on request if the consumer's right to such notices is disclosed.

Needless to say, the interrelation of these provisions is often confusing, both to creditors who must comply with both provisions and to the consumers who must attempt to sort out the sometimes contradictory disclosures that the two statutes provide. Some consumers receive a notice under the Fair Credit Reporting Act ostensibly giving the reason for denial, accompanied by a separate notice stating that the consumer may request a specific reason for denial under the ECOA. Some creditors, after complying with one provision, may simply overlook the other. We would recommend that in the case of credit transactions,[2] the two provisions should be integrated into a single statutory provision with consistent rules.

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[2] Section 615(a) of the FCRA applies to denials of employment and insurance as well as credit. It is, therefore, important that denials of employment and insurance remain covered by the Fair Credit Reporting Act.

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B. Simplification of the Fair Credit Billing Act Dispute Resolution Procedures

The Fair Credit Billing Act currently sets detailed rules which consumers must follow in filing billing disputes. To ensure that consumers are aware of these rules, the Act provides for the annual mailing of a notice to consumers setting forth the rules they must follow. The Federal Reserve Board's 1977 Consumer Credit Survey shows that the annual notice requirement has been unsuccessful (at least during the 1975-77 period) in alerting consumers to their rights and responsibilities under the Fair Credit Billing Act. Only 16% of the consumers surveyed even knew that there was a Federal law dealing with credit card billing errors, despite the fact that they regularly receive notices announcing this fact. Moreover, the experience of Commission staff with the Act suggests that few consumers follow all the procedural steps necessary to invoke the Act's protection.

Correction of these problems could be accomplished by eliminating the formal procedures consumers must follow to file a billing error notice, particularly, for example, the requirement that the notice be mailed to a specific address and that the

notice contain certain specified information. This, in turn, would eliminate any need for the creditor to send the consumer a statement of Fair Credit Billing rights until after the consumer files a billing complaint. If a consumer sent a billing complaint to a different address than the one specified, the time period for correction could be delayed, until the complaint was forwarded to the billing department. Similarly, if the consumer did not adequately identify the account or describe the error, the creditor would simply write back requesting the necessary information before being required to reinvestigate the error.

Both of these areas are examples of changes which could be made in existing laws which would be beneficial to both creditors and consumers. Moreover, we believe that the changes could be made without causing any disruption of creditor operations since they would not involve changes in forms and would require few, if any, changes in existing procedures.

3. Disclosures for Alternative Mortgages

One reason why Truth in Lending regulations in the past tended to be complex is that credit transactions themselves are often complex, and are becoming more so. Nowhere is this more true than in the new area of alternative mortgage financing.

In shopping for traditional, fixed-rate mortgages, consumers faced relatively straightforward shopping decisions. The consumer essentially needed only to compare the annual percentage rate, its components of interest and pre-paid finance charges ("points"), and the size of the monthly payment. In the recent past, however, credit shopping has become much less simple. Not only must consumers distinguish among an array of available mortgage instruments -- including shared appreciation, graduated payment, variable rate and rollover mortgages -- but they must also assess the relative benefits of having their interest rates tied to a specific index such as the three-month treasury bill rates, the Federal Home Loan Bank Board's average cost of funds, or the monthly average yield on Treasury securities. In other words, effective shopping for mortgage credit may now require consumers to make sophisticated judgments about the prospective performance of indices whose very existence is presently unknown to the average cnsumer.

The new mortgage alternatives may also raise difficult problems with respect to credit advertising. If, for example, a loan plan were offered which provides for 6-3/4% financing for a period of time followed by an increase to the then current rate on a specific index, an advertisement mentioning only that the creditor offers 6-3/4% financing, subject to change, might be

legal. Previously such advertisement would have been required to provide at least an estimate of the rate for the entire period of the loan. Thus, consumers may be receiving less information for alternative mortgage instruments than they presently receive for conventional ones, despite the relative novelty and complexity of the former as compared with the latter.

Of course, as variable rate mortgages become more common, they should become more familiar to consumers. Moreover, as deregulation of financial services proceeds, the various indices that determine the cost of alternative mortgage credit may become more closely correlated. Even if these developments occur, however, consumers may still have difficulty understanding and comparing the costs and benefits of the various financing alternatives now available to them.

Let me emphasize that the Commission strongly favors recent trends that are increasing the competitiveness of the credit market. Alternative mortgage instruments should encourage new avenues of competition among lenders, while permitting them to respond to changing market conditions. These instruments also offer important benefits to consumers, in the form of more available and more flexible sources of financing for home purchases. At the same time, these instruments create the

potential for confusion as well as manipulation. We think there is a clear need to monitor the implementation of these changes in the credit market to ensure that consumers are able to shop effectively among the available alternatives and that lenders are able to compete fairly with one another for consumer business.

4. Usury

Despite recent efforts by many states to raise or eliminate their usury rates, state usury laws remain an issue of great concern.

The Depository Institution Deregulation and Monetary Control Act of 1980 preempted state usury laws governing home mortgages and mobile homes. State laws were also partially preempted for all loans by federally insured depository institutions and all loans of more than $25,000 for business and agricultural purposes. In some cases, the preemption was permanent (subject to state legislative override) and in others it was temporary. More recently, the Federal Home Loan Bank Board has preempted state laws that prohibit use of variable rate mortgages.

The National Bank Act allows national banks to lend at the highest rate available to any creditor in the state in which the bank is located. This grants national banks a "most favored lender" status within the state, and partially preempts the usury law of the state in which the bank is located. In addition, the National Bank Act has been interpreted to allow the exportation of usury rates from one state to another state by national banks. Thus, state legislators in South Dakota can now set the rates which will be charged New York residents who are customers of national banks physically located in South Dakota. There is currently some question whether these same privileges are available to other Federally insured depository institutions; however, it is clear that the privileges are not available to retailers and other creditors.

The current situation is chaotic, and there is no clear consensus as to a remedy. Most lenders favor full Federal preemption of all state usury laws. Most state officials strongly oppose any further Federal encroachment in an area that has been traditionally regulated by the states. While the presumption is that most consumers favor an adequate supply of credit at a reasonable price, in at least one state a voter referendum defeated attempts to raise usury rates beyond a very low level.

Although there is substantial evidence that unrealistically low usury rates restrict the supply of credit, we have not yet seen any data clearly indicating that there is sufficient

competition in all credit markets (for example, the small loan market or "easy credit" retail markets) to regulate rates effectively in the absence of some state-imposed ceilings. At the same time, however, there is a similar absence of data showing that markets are not sufficiently competitive or that state imposed ceilings, in the long run, are necessary to protect consumers. The FTC has in the past supported creation of a group to study the issues raised by Federal preemption of state usury laws, and we again recommend that approach.

5. Extension of Fair Debt Collection Practices Act to Creditors

The Fair Debt Collection Practices Act sets a code of conduct for debt collectors and prohibits most of the abusive, deceptive or unfair practices that were utilized by unscrupulous members of that industry prior to its passage. While debt collectors are now prohibited from engaging in such practices as calling the debtor's neighbors and employer in attempting to collect a debt, creditors are not. Although it has always been assumed that creditors are less likely to engage in unconscionable collection practices than debt collectors, our experience is that at least some creditors continue to engage in the very same practices which would be illegal if they were subject to the Fair Debt Collection Practices Act. While the

Commission is continuing to police the collection activities of creditors under the Federal Trade Commission Act, as we did prior to the passage of the Fair Debt Collection Practices Act, our ability to do so is limited both by available resources and the fact that many creditors are not under our jurisdiction. Thus, we again recommend that the relevant provisions of the Fair Debt Collection Practices Act be expanded to include creditors.

I hope that your Committee will find this information helpful and I would be happy to respond to any questions the Members might have.

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF THE CHAIRMAN

8 JUL 1981

Honorable Richard G. Lugar
United States Senate
5107 Dirksen Office Building
Washington, DC 20510

Re: Federal Preemption of State Usury Laws

Dear Senator Lugar:

This is with reference to your letter of May 13, 1981 requesting the Commission's views on whether Congress should further preempt interest rate ceilings on consumer credit. In addition, your letter requested comments on H.R. 2501, a bill to deregulate the interest rate on business and agricultural loans and consumer credit.

Your letter requested that the Commission address these questions during its testimony on May 18, 1981 before the Senate Banking Committee. The issue of further federal preemption of state usury laws is addressed on pages 11-13 of the attached Commission statement which was presented at that hearing. As indicated in that statement, despite recent efforts by many states to raise or eliminate state usury ceilings, state rate ceilings remain a matter of serious concern. While the Commission believes, as did the National Commission on Consumer Finance, that there may be no need for state usury laws in credit markets if there is sufficient competition to ensure that consumers pay a reasonable charge for credit, it favors the creation of a federal "Usury Study Commission," primarily to determine whether there are credit markets in which there is currently insufficient competition to regulate such charges. As discussed in a previous staff statement on such a proposal (attached), a usury study commission could also address:

- Whether lifting of rate ceilings should be immediate or whether ceilings should be gradually phased out, as is being done in the case of Regulation Q's interest rate ceilings on deposits.

- Whether federal action should be subject to a state override, and if so, whether the state should be required to act in a specific time period and a particular manner if it wishes to override the federal standard.

- Whether a floating federal ceiling tied to an economic indicator such as the local Federal Reserve Board's discount rate should replace

preempted state laws. This was done for business and agricultural credit, as well as all loans by federally insured depository institutions, in the Depository Institution Deregulation and Monetary Control Act of 1980.

- Whether federal preemption of state usury laws should be accompanied by the prohibition of other credit practices which exist as an outgrowth of state usury laws, such as the use of the Rule of 78's to calculate refunds of unearned finance charges.[1]

- Whether the Federal Extortionate Credit Transaction Act, 18 U.S.C. §892, which makes an extension of credit at a rate in excess of 45% an element of a prima facie criminal case, should be retained or strengthened.

A brief review of H.R. 2501 also indicates the need for careful evaluation of the method used to preempt state usury laws if that action is found appropriate. For example, H.R. 2501 limits a state's right to override the federal preemption to a period of three years, thus preventing states from responding to abuses which develop more than three years in the future, perhaps in isolated, local credit markets. Similarly, although at least three states have already overriden the federal preemption under the Depository Institution Deregulation and Monetary Control Act of 1980, H.R. 2501 would appear to require those states to act again with respect to the same classes of transactions on which they previously acted.

The Depository Institution Deregulation and Monetary Control Act of 1980 preempted primarily state laws which limited the interest rate which could be charged on certain credit transactions,[2] while H.R. 2501 preempts all laws limiting interest,

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1 See, e.g., Hearings before the Subcommittee on Consumer Affairs of the Committee on Banking, Housing and Urban Affairs of the United States Senate on S. 2002 (December 10 and 11, 1979).

2 For mortgages, the law preempts limitations on all charges but specifically reserves to the state that right to limit charges other than interest (e.g., points or discounts) at any time and in any manner.

finance charges and other charges or fees, including transaction fees and access fees. This obviously broader preemption could be construed to preempt state laws limiting, for example, the amount which a creditor may charge for credit life insurance and the amount of prepayment, late payment, default, acceleration and similar charges which may be imposed. Unlike interest charges, credit life insurance premiums, prepayment, late payment, default and acceleration charges may not be subject to effective competitive forces[3] and state laws dealing with them should not necessarily be preempted.

Similarly, H.R. 2501 also appears to preempt state laws regulating the manner in which charges are imposed rather than merely the amount of the charges. Thus, state laws requiring creditors to use, for example, the "average daily balance" of a credit card account on which to calculate the finance charge would be preempted, as would state laws prohibiting creditors from assessing interest on interest. Because a creditor may increase its yield on the account by selecting a more favorable method of computing the finance charge, without raising the disclosed annual percentage rate, many states specify the manner which must be used in order to ensure fairness and effective competition. Preemption of those state laws would seem unnecessary to the goals of H.R. 2501.

Finally, Section 531(b) of H.R. 2501 attempts to preserve other existing state regulatory structures and consumer protection statutes. Under the laws of many states the consumer protection and regulatory structure is tied to the rate

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[3] Under the revised Truth in Lending Act, for example, default and acceleration charges need not even be disclosed to the consumer. Credit life insurance charges have, in the past, been found susceptible to reverse rate competition, that is, competitive forces tend to raise the charge rather than lower it. National Commission on Consumer Finance, Consumer Credit in the United States (1972) at 86; National Association of Insurance Commissioners, a Background Study of The Regulation of Credit Life and Disability Insurance (1970) at 19-22.

structure. For example, under the Uniform Consumer Credit Code (which is the law in Colorado, Idaho, Indiana, Oklahoma, Utah, Wyoming and Maine), a "regulated loan" is defined as a consumer loan in which the finance charge is in excess of 10% per year calculated on the unpaid balance of the principal, and a "supervised loan" is defined as a regulated loan in which the finance charge exceeds 18%. Section 3.501 of the UCCC. A creditor essentially elects to be a licensed lender in order to be entitled to charge a higher rate of interest. In these states preempting state usury laws would appear to have an undetermined impact on this regulatory structure. The Commission would therefore recommend close consultation with state officials to attempt to remedy any such problems prior to the passage of legislation.

The Commission appreciates the opportunity to comment on this bill, and hopes that you will find this information useful.

By direction of the Commission.

David A. Clanton
Acting Chairman

Statement of

Lewis H. Goldfarb
Assistant Director
for Credit Practices
of the
Bureau of Consumer Protection
Federal Trade Commission

on

H.R. 7340 - The Cash Discount Act
and
Proposals for A
Consumer Usury Study Commission

Before

The Subcommittee on
Consumer Affairs of
The Senate Committee on
Banking, Housing and Urban Affairs

Thursday, July 24, 1980

The remarks represent the views of the Staff of the Bureau of Consumer Protection and do not necessarily represent the views of the Commission or of any particular Commissioner.

GOOD MORNING:

Thank you for the opportunity to appear before you today to present the views of the staff of the Federal Trade Commission's Bureau of Consumer Protection on H.R. 7340, the Cash Discount Act, and this Subcommittee's proposal to create a national commission to study federal preemption of state usury laws. My comments today represent my own views and do not necessarily represent the views of the Commission or of any particular Commissioner.

Consideration of these two subjects is timely and they are clearly related. The Truth in Lending Act's present cash discount provisions now permit partial preemption of state usury laws and the proposed Cash Discount Act would eliminate the present 5% ceiling on such discounts thus greatly expanding the preemption. Moreover, as you know several segments of the credit market have already been subjected to a full or partial preemption of state usury laws and other representatives of other sectors are currently seeking similar exemptions.

I. Proposed Consumer Usury Study Commission

We strongly support creation of the proposed consumer usury study commission to examine the issues raised by any further Federal preemption of state usury laws. We believe that there are significant questions which should be carefully reviewed and answered prior to further federal action.

Usury laws represent one of the longest standing and most common

forms of economic regulation. The National Commission on Consumer Finance traced such laws as far back as the 24th century B.C. Every state in this country has some form of usury laws. Moreover, such laws have significant individual impact for almost every consumer. Before such laws are preempted by federal legislation, further examination is appropriate.

Much debate on this topic has already occurred. Economists for years have pointed out that in many cases usury laws may disrupt orderly allocating of credit costs by the market, restrict the available supply of credit and, in some cases, actually increase the cost of credit by serving as a barrier to entry to the market. The National Commission on Consumer Finance devoted a substantial portion of its resources to examination of rate ceilings. While the Commission concluded that, on balance, rate ceilings were undesirable, it did not recommend immediate abolition, but instead counseled states to evaluate the competitiveness of their markets before considering raising or removing the ceilings. [1] I view this as one of the most important questions which a study commission should address: are there presently credit markets which are not sufficiently competitive to justify removal of rate ceilings?

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1 Consumer Credit in the United States, Report of the National Commission on Consumer Finance (1972) 108, 147-149.

There are, of course, a host of other questions, which should be answered, many of which are outlined in your letter of July 12. Of particular importance are the questions of:

-- Whether the lifting of rate ceilings should be immediate or gradual?

-- Whether any federal action should be subject to a state override?

-- Whether a maximum rate should be tied to some economic indicator or the Federal Reserve Board discount rate?

-- What the impact on other federal laws and regulations would be? [2]

From the standpoint of consumer protection, a particularly important issue is whether consumers should be granted additional protection as a result of raising rates, for example, limitations of creditor remedies and collection practices or prohibition of the use of the "Rule of 78's" to calculate refunds of unearned finance charges.

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[2] The Extortionate Credit Transaction Act, for example, makes an extension of credit at a rate in excess of 45% an element of a prima facie case or criminal case. Other Federal regulations set maximum charges for certain government guaranteed credit transactions.

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It may be argued that once creditors are granted relief from rate limitations they should not be permitted to impose additional hidden costs in the form of onerous collection remedies or prepayment penalties. High rates coupled with harsh collection practices might ultimately be found to cause more harm than good.

II. The Cash Discount Act

We are in general support of the purpose of the Cash Discount Act, which we understand is to encourage more merchants to establish cash discount programs. As to that Act, I have only three recommendations. First, I believe the existing statute's requirement that the cash discounts must be generally available to all cash customers is an important one and should be retained. This provision ensures that consumers who do not have credit cards can receive the discounts.

Secondly, the Act removes the existing 5% ceiling on cash discounts. In our experience, the limitation on the amount of the discount has not been a particularly important reason for the general reluctance of merchants to offer cash discounts. Because I fear that an unlimited discount could be used to subvert the Truth in Lending Act's general policy of promoting informed use of credit through full disclosure of cost, I believe some ceiling should be retained, at least until the proposed study commission has had an oportunity to evaluate this area.

The most significant issue raised by H.R. 7340, however, is its continued prohibition of surcharges on consumers who use credit cards. In our experience small merchants who adopt programs to ensure that cash customers do not pay the costs associated with accepting credit cards, invariably do so by imposing a surcharge rather than granting a discount for cash. It is too cumbersome and costly for them to effectively offer discounts for cash. In cases in which we have contacted these merchants to notify them that the practice is illegal, the uniform response has been to abandon the program, not to institute a cash discount program. Moreover, in at least one case, the merchant expressed dismay that the law allowed him to raise his cash price and then grant a discount but not to take the much simpler step of simply imposing a surcharge.

From an economic standpoint, a surcharge and a discount are equivalent concepts except that one is hidden in the cash price and the other is not. From a practical standpoint, the surcharge seems easier to implement and more likely to ensure that the cash price does not reflect the cost of accepting credit cards. [3]

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3 There are inherent costs in accepting these cards including the discount the merchant pays the card issuer and administrative costs. There is, however, an underlying economic question of whether the increased sales from credit card programs actually result in lower cash prices for all customers.

Ultimately, the question of whether credit card issuers themselves should be able to impose surcharges, transaction charges or seek additional forms of compensation not now permitted by state law will be faced by the proposed study commission. As an interim measure, I would recommend that the Cash Discount Act be amended to allow merchants accepting third party credit cards to impose a surcharge which is equal to the amount of the discount the merchant will pay the card issuer. If such a provision is enacted it should be coupled with a provision requiring merchants to clearly disclose that they impose such surcharges both at point of sale and in any advertisement stating that they accept thir[illegible] c[illegible]it cards.

I hope that you will find [illegible] assistance in considering this legislation.

NATIONAL ASSOCIATION OF CONSUMER CREDIT ADMINISTRATORS

NACCA

JUL 15 AM 7:55

July 6, 1981

The Honorable John Tower
United State Senate
Room 142
Russell Senate Office Building
Washington, D.C. 20510

Re: S. 1406

Dear Senator Tower:

I am writing on behalf of the National Association of Consumer Credit Administrators (NACCA) concerning S. 1406.

NACCA is comprised of Administrators from 44 of the 50 United States Guam, Puerto Rico and Canada. The purpose of our Association is to improve the supervision of Consumer Credit Agencies and to facilitate the administration of laws governing these agencies. We support no legislation whether it be state or federal which is not in the best interest of the consumer credit public.

In May 1980, NACCA adopted a resolution reaffirming our support of the statutes and regulations adopted by the various states including their provisions on rates and charges limitations on agreements and practices and urging the United States Congress to undertake no further preemption of state laws with respect to consumer credit rates or practices. A copy of this resolution is enclosed. In May 1981, NACCA passed a motion joining the American Conference of Uniform Consumer Credit Code States in opposing H.R. 2501.

S. 1406 is quite similar to H.R. 2501 and would preempt state laws with regard to consumer credit rates and charges. While our principal objection to S 1406 is its preemption of state consumer credit laws, we also believe that it is not in the best interest of the consumer. An area of major concern is the definition of "Covered Charges" under Sec 532(a (1) where the potential for abuse by creditors appears to be great. Therefore, our Association opposes S. 1406 as well as any similar legislation.

Your consideration of our views with respect to this matter would be appreciated.

Very truly yours,

William G. Noble
William G. Noble
President

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C/O Office of Commissioner of Banking
30 West Mifflin, Room 401
P.O. Box 7876
Madison, WI 53707

NATIONAL ASSOCIATION OF CONSUMER CREDIT ADMINISTRATORS

NACCA

"To support no legislation which is not in the best interest of the consumer credit public"

RESOLUTION

WHEREAS, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), Title V of which preempts State laws limiting rates and charges on certain consumer credit transactions; and

WHEREAS, Title V, Sections 501 and 521 preempt statutes and regulations as adopted in various States for certain consumer credit loans and sales made after March 31, 1980; and

WHEREAS, Congress has and will have under consideration further efforts to preempt state consumer credit rates and other practices; and

WHEREAS, the various State statutes and regulations constitute a body of balanced state law whose purposes include providing rate ceilings to assure an adequate supply of credit to consumers and protecting consumers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors, and

WHEREAS, Section 501(b)(2) and 525 permit the States to adopt a law explicitly and by its terms stating that a State does not want the various provisions of Title V to apply to consumer loans and credit sales made in such State.

NOW, THEREFORE, BE IT RESOLVED by the National Association of Consumer Credit Administrators that the Association reaffirms its support of the statutes and regulations as adopted by various States, including their provisions on rates and charges and limitations on agreements and practices, as the proper approach to assuring an adequate supply of consumer credit and specifically declares that Federal legislation is this area is undesirable, unnecessary and has, in many cases, resulted in the preemption of State laws more responsive to the needs of the citizens of the individual States; and

BE IT FURTHER RESOLVED that the N.A.C.C.A. urges that the U. S. Congress undertake no further preemption of state laws with respect to consumer credit rates or practices so as to allow the individual states an opportunity to study and enact needed reforms in their consumer credit statutes and urges the consumer credit administrators in all States to support this position, and

BE IT FURTHER RESOLVED that the N.A.C.C.A. urges the individual States to promptly review their state statutes preempted by P.L. 96-221 and seek to override these preemptive effects where it is determined to be desirable so as to demonstrate to the Congress that future preemption of state consumer credit laws is unnecessary in that States are capable and in favor of regulatory reform to respond to changing conditions in the consumer credit field and urges that the consumer credit administrators in all States support this position.

Given under my hand by the authority invested in me and in accordance with the will of this N.A.C.C.A. convention this 19th day of May in the year 1980

[signature]

George F. Wolf, President
National Association of Consumer Credit Administrators

National
Farmers Union

STATEMENT OF

ROBERT J. MULLINS
DIRECTOR OF LEGISLATIVE SERVICES
NATIONAL FARMERS UNION

SUBMITTED TO THE

FINANCIAL INSTITUTIONS SUBCOMMITTEE
BANKING, HOUSING & URBAN AFFAIRS COMMITTEE
UNITED STATES SENATE

CONCERNING

S. 1406
"CREDIT DEREGULATION AND AVAILABILITY ACT OF 1981"

WASHINGTON, D. C.

July 15, 1981

- - - -

Mr. Chairman:

National Farmers Union appreciates the opportunity to submit its views on S. 1406, the "Credit Deregulation and Availability Act of 1981". Agriculture, and consumers in general, cannot take another dose of "deregulation" if the purpose and effect of such action results in a further increase in the cost of credit. We find nothing in this legislation which will make credit available to farmers or other users of credit at reasonable interest rates. On the contrary, such legislation will have the opposite effect.

On the short-term loan side, almost all of the debt on many farms is rotated every year. It is paid off and new loans are drawn. There are some loans, for example, on farm machinery purchases, which may run three to five years in duration. But, as best as we can calculate, these longer-term "short-term" loans make up only about one-eighth of the non-real estate debt burden. It is on this 88 percent of the farm debt that the impact of additional interest rate deregulation would be most adversely felt by farmers and ranchers.

I recommend to this Subcommittee that you carefully analyze the statement by the National President of the Farmers Union, George Stone, which I am attaching, concerning the impact of credit policies on American

agriculture. After reviewing this document, I suggest that you will agree that legislating higher interest rates is not the answer. The Congress must act to reduce interest rates which will, in the process, help alleviate its twin demon, high levels of inflation.

We are also somewhat confused by the philosophy of this measure. At a time when the Administration and many Members of Congress are advocating a greater role for the states in managing their affairs, legislation such as this, invalidating portions of state constitutions and state statutes, seems contrary to that philosophy.

I hope this Committee carefully considers the impact on American agriculture and its farm families if it acts to increase the debt burden on farmers at the same time that farm prices are declining (see Attachment B).

National
Farmers Union

ATTACHMENT "A"

STATEMENT OF

GEORGE W. STONE
PRESIDENT
NATIONAL FARMERS UNION

before the

SUBCOMMITTEE ON CONSERVATION, CREDIT AND
RURAL DEVELOPMENT
COMMITTEE ON AGRICULTURE
U. S. HOUSE OF REPRESENTATIVES

Concerning

"THE IMPACT OF CREDIT POLICIES
ON AMERICAN AGRICULTURE"

Washington, D. C.
June 23, 1981

Mr. Chairman and Members of the Subcommittee.

I am George W. Stone, President of the National Farmers Union, Denver, Colorado. I appreciate the opportunity to appear before the Subcommittee today on behalf of the members of the National Farmers Union and commend the Chairman for holding this hearing on a subject which is of immediate concern to the farmers and ranchers of this country.

Credit availability, federal credit policy and record high interest rates are having a severe impact on America's farmers.

The high cost of farm borrowings is the most obvious and staggering of the effects of the extraordinarily high interest rates being maintained by the Federal Reserve Banking system despite a lack of apparent beneficial effects. But the direct cost to farmers is only one of the many damaging impacts of the high interest levels which have bounced around between 17% and 21% for most of this year. The latest reports average interest rate paid by farmers for such things as livestock, feed, farm operations, machinery, etc., is 17.92%, almost four points higher than a year earlier, an increase of 27% in the going interest rate. The net effect is that as farmers borrow more, they have less ability to repay the loans.

Suite 800, 1012 14th Street, N.W., Washington, D.C. 20005 – Phone (202) 628-9774

-- FARM INTEREST OUTLAYS. Farmers will pay more than $20 billion in interest in 1981 on their current debt of $180.5 billion compared with their outlays of $16.5 billion in 1980.

-- CCC LOAN RATE COSTS. The current CCC interest rate on commodity loans is 14½%. At the existing 1981 crop loan rates, that is a cost to farmers of 46.40¢ a bushel on wheat and 34.80¢ a bushel on corn for 1981 regular loans. If the first year waiver of interest is terminated on farmer-held reserve loans, it will cost farmers 50.75¢ a bushel on wheat and 36.98¢ a bushel on corn.

-- REDUCED PROSPECTS FOR GRAIN EXPORTS. At the start of this year, it was predicted that U.S. farm exports would set a new record value of $48.5 billion in 1981. Now, because high interest rates affect the cost of handling grain inventories and due to other factors, predictions are that exports will have a value of only about $46 billion.

-- NO REDUCTION IN CREDIT USE. High interest rates are a crude and ineffective way of discouraging credit use, at least as far as farmers are concerned. At the end of March this year, farmer borrowings from major commercial banks was running 10% higher than a year ago, at a rate of $5.4 billion in loans per week, compared to $4.9 billion a year earlier.

-- INFLATION RATE IS ACCELERATED BY HIGH INTEREST RATES. Since high interest rates become wrapped up into costs of all industrial and consumer goods and services, they tend to aggravate inflationary pressures, rather than reduce them.

-- COST OF GOVERNMENT SHARPLY INCREASED. High interest rates inflate the cost of government at all levels. For the federal government alone, interest outlays for fiscal year 1982 will be $106.5 billion, up from $94 billion. The interest outlays in fiscal 1982 will be $65 billion higher than in 1977 when the basic cost of money was about 6%.

-- GOVERNMENTAL DEFICITS ARE AGGRAVATED. The $65 billion cited above would be enough by itself to bring the fiscal 1982 federal budget into balance. It is a waste which should no longer be tolerated.

-- ABILITY OF FARMERS TO GENERATE CAPITAL INTERNALLY IS REDUCED. In the year of 1970, U.S. farmers relied on new loans, or a net increase in loans, for only 5% of the cash sources of funds for their operations. In 1981, farmers are substituting credit for income at an alarming rate, with borrowing accounting for 23% of their cash sources of operating funds.

-- PURCHASING POWER OF CONSUMERS DIVERTED FROM FOOD, OTHER NECESSITIES. The tripling of effective interest rates since 1977 on consumer loans has diverted $30 billion of purchasing power from food, housing and other necessities. Indirectly, therefore, high interest rates depress the effective demand for products of American farms.

-- COMPETITION FOR FUNDS SIPHONS MONEY AWAY FROM THE FARM SECTOR. With the advent of high interest rates has come a proliferation of money market funds and other investment opportunities which are drawing several billion in loanable funds from agricultural purposes. The adverse effect upon country banks, which normally service farm borrowers, has been particularly notable.

- - -

Early in 1977 -- about four years ago -- the prime interest rate was at 6.25 percent. The prime rate, which is the pace-setter for interest rates generally, advanced to 11.75 percent by the opening of 1979, and since then we have seen the prime rate rise to as high as 21½ percent.

Such record interest rates, coming at a time when farm debt is also ballooning to record levels, is extracting a fearful price from farmers. We maintain that had the basic interest rate remained at reasonable levels, the net income of U. S. farmers would have been substantially higher the last several years.

According to our calculations, about $12 billion in income has been diverted from the income side to the cost side of farm balance sheets due to the impact of the higher interest rates.

As we attempt a general overview of the money and credit crisis, we recognize that as important as these overall statistics and trends may be, there is always the possibility that we may lose sight of the human element -- the farmers and the farm wives and family members and the manner in which they feel the effects of the debt burden and the high interest rates.

We call your attention to the dimensions of the credit crisis in ATTACHMENT "A".

On January 1, 1981, the outstanding debt of U. S. farmers was $180.5 billion -- an increase of $23 billion or 15 percent in a year's time. That is twice what it was five years ago and more than seven times what it was in 1960.

In ATTACHMENT "B", we show the annual average prime rate for the past 31 years together with the monthly figures for the past five years.

The prime rate is now almost ten times higher than it was in 1949 and about three times what it was early in 1977.

In ATTACHMENT "C", we show the interest outlays by farmers over the past 20 years, from a grand total of $1,269 million in 1960 to $16.5 billion for 1980. That is more than a 12-fold increase from 1960 and more than a doubling in just four years.

It is sometimes maintained that the changes in interest rates do not make themselves immediately felt. The interest rates in some mortgages and many promissory notes are fixed, and so the new rates do

not become an immediate problem. However, that assumption can be misleading.

In referring to ATTACHMENT "D", we show that only about 26 percent of real estate debt and only 12 percent of short-term debt is not immediately affected by interest rate changes.

About 31 percent of the outstanding real estate debt each year is new borrowing -- so that will be affected by the new rate. The Federal Land Bank system, which accounts for one-third of the real estate lending, is now largely on a variable interest rate basis. The rates float according to prevailing market conditions and so these loans are affected soon, if not immediately, by the new rates.

On the short-term loan side, almost all of the debt on many farms is rotated every year. It is paid off and new loans are drawn. There are some loans, for example, on farm machinery purchases, which may run three to five years in duration. But, as best as we can calculate, these longer-term "short-term" loans make up only about one-eighth of the non-real estate debt burden.

In ATTACHMENT "E", we show the farm debt-to-asset ratio over the past forty years.

While the ratio looks modest -- about one dollar of debt for each six dollars of assets -- the figure is still on the high side.

The January 1, 1980, ratio of 16.1 is the most unfavorable since 1941.

A more meaningful measurement is the rate of substitution of credit for income which we show in ATTACHMENT "F" relating to the cash sources of funds of farm operators.

What this shows is that farm operations are not generating internal capital as they have or as they should but instead are increasingly dependent on borrowed funds for cash operating money.

In 1970, new loans -- or the net increase in loans -- represented only five percent of the cash sources of funds of farmers.

By 1975, this figure had risen to 12 percent, and in 1978 and 1979, it has amounted to more than 17 percent. In 1980, farmers were borrowing money for 20 percent of their cash sources of operating funds.

In ATTACHMENT "G", we look at several measures of the ability of farmers to handle their debt burdens.

The first of these is the U. S. parity ratio -- currently at 63 percent of parity. What it means is that farms are able to pass through only 63 percent of their operating costs (including interest) in the price of their products.

The second item shows the per capita income of farmers from farming compared to the per capita income of non-farmers. The ratio of

62 percent is not a good omen of the viability of farming as an economic enterprise.

In the third item, we show the return to farm equity compared to the rates of profits in selected manufacturing industries. Again, the 3.6 percent farm rate in 1978 does not compare well with the 24 percent rate in all manufacturing enterprises. A rate of 4.1 indicated only slight improvement in 1979.

It is sometimes contended that the growth of farm debt and the high interest rates are offset by the spectacular growth of the value of farm assets.

However, item four is worth some study. It shows that from 1975 to 1979, if inflation is deleted, farm real estate values have actually declined.

Now, of course, the higher land values do make it possible to incur larger debts.

But what it does is increase farmers' ability to borrow, without increasing their ability to repay.

Repayment depends on income -- and we should never lose sight of that.

It is important to understand that the Nation's farmers are also affected by what high interest rates do to the remainder of the national economy. Obviously, the higher interest rates are diverting consumer purchasing power which could be used for food, for housing, for automobiles and other manufactured goods.

Should anyone be surprised that the housing construction industry is ailing with housing mortgages at interest rates of 16 percent and more?

Should anyone be surprised that American cars are not selling with car finance costs where they now are?

You have all been told many times that these tight-money, high-interest-rate policies are justified on the basis that they will reverse inflationary pressures and save the value of the dollar.

Perhaps farmers would be willing to go through the wringer, workers to be unemployed, and other citizens to forego purchases of a house, a car or other major items, and our whole society to accept a lower standard of living, if it achieved anything in the war on inflation.

But that policy is not succeeding -- it never has without precipitating depression -- and it probably never will.

A BETTER ANTI-INFLATION STRATEGY IS AVAILABLE
In the Emergency Credit Control Act of 1969
(Title II of Public Law 91-151)

In early 1980, the Carter Administration attempted half-heartedly and largely ineffectively to use the credit restraint provisions of

P.L. 91-151 to help curb inflationary pressures.

The effort was abandoned a brief two months later without ever making use of some of the very significant tools which were available.

Later, the Congress voted to terminate the Emergency Credit Control Act of 1969, but made the termination effective June 30, 1982. Therefore, the authority still is available to the President and could be used by the President to direct the Federal Reserve Bank board to take certain constructive actions in the campaign against inflation.

We acknowledge that credit controls and credit allocation are drastic tools, but conditions are desperate and the strategies of the Federal Reserve under the Carter Administration and under the Reagan Administration, up to this time, have been entirely ineffective in curbing inflation.

We see no prospect that the super-tight money policies of the Federal Reserve system will bring about the needed economic cure.

One may not like the prospects of credit controls or credit allocation, but the alternatives are absolutely intolerable --

-- Runaway inflation is worse,

-- Recession is worse,

-- High unemployment is worse, and

-- Hardship for those at the dawn of life, or those at the twilight of life, or those in the shadows of life (the disadvantaged, the handicapped and the poor) is worse.

These alternatives are not viable alternatives for the American society and they should make way for an effective, though stern, medicine of credit controls and allocation.

The language of Title II of the 1969 Act deserves close reading since it provides broad powers for the President:

Section 205 of the law provides that:

"Whenever the President determines that such action is necessary or appropriate for the purpose of preventing or controlling inflation generated by the extension of credit in an excessive volume, the President may authorize the Board to regulate and control any or all extensions of credit."

Section 206 lists the actions which the President may direct the Federal Reserve Board to take, including:

"Prescribe the maximum amount of credit which may be extended,
"Prescribe the maximum rate of interest, maximum maturity, minimum periodic payment, maximum period between payments, and any other specification or

limitation of the terms and conditions of any extension of credit.
"Prohibit or limit any extensions of credit under any circumstances the Board deems appropriate."

As we read this statute, we believe it contains authority for a roll-back of interest rates to any level which the President may direct. It contains authority to allocate credit to productive uses such as farming and food distribution, to housing, to basic industries and to small business.

It contains the authority to prevent the flight of capital to foreign countries to avoid the effects of the domestic credit controls.

If the White House would use this authority to roll back the cost of money even to the then relatively-high level of 6½% which prevailed in April, 1977, it would result in these savings to the American people:

-- A $12 to $14 billion reduction in annual interest rate outlays for American farmers;

-- A $60 to $65 billion reduction in annual interest outlays by the federal government (enough alone to balance the fiscal 1982 budget);

-- A $200 billion reduction in interest outlays by American households, individual consumers, and other borrowers.

THE NEED TO EXTEND THE ECONOMIC EMERGENCY LOAN PROGRAM
Authorized in the
EMERGENCY CREDIT ADJUSTMENT ACT OF 1978
Public Law 95-334

On many American farms in 1981, interest outlays will be the single largest expense item, exceeding even the cost of feed purchases and the cost of purchased livestock.

The outstanding debt of U.S. farmers (which began this year at $82.5 billion) is now thought to be approaching $200 billion. Farmers depend on commercial or independent financial sources, such as commercial banks, life insurance companies, federal land banks and individuals for 91% of their real estate loans. They depend on commercial or independent sources such as banks, Production Credit Associations (PCA's) and individuals for 77% of their short-term borrowing (non-real estate).

About 15.4% of the non-real estate borrowing is from the Farmers Home Administration (FmHA) and 3.3% from the Small Business Administration.

Yet for farmers, who cannot get financing from other sources, the 9% of the real estate loans and the 18% of the short-term loans which they get from federal government sources, are vital to their survival in farming. Disaster loans are such last resort loans.

Responding to a severe crisis in 1978, Congress and the President approved the "Emergency Agricultural Credit Adjustment Act of 1978", Public Law 95-334, which included a new economic emergency loan program.

Under this section, USDA is authorized to insure and guarantee loans to family-scale farmers not able to obtain sufficient credit from normal sources to finance actual needs at reasonable rates and terms due "to national or areawide economic stresses, such as the general tightening of agricultural credit or an unfavorable relationship between production costs and prices received for agricultural commodities."

P.L. 95-334 authorized up to $4 billion in such economic emergency loan programs through May 15, 1980. Subsequently, in March, 1980, the law was extended with another $2 billion in loan authority through September 30, 1981.

From early 1979 through June 10, 1981, some 115,823 economic emergency loans have been made, totalling $6.3 billion. Since some repayments have already been made, a total of $404 million in unobligated funds are available for loans in the remainder of the year ending September 30th.

In view of the current projection that total net income of U.S. farmers may be as poor as the disaster year of 1980 and because of the huge debt load of farmers and the extraordinary interest rates, it is important that the Congress act to extend the economic emergency loan program for at least two years beyond the scheduled expiration on September 30th.

The House Agriculture Committee has recommended a one-year extension of the economic emergency loan program, but without any additional loan authority.

We think that the extension should be for two years with at least another $4 billion in loan authority.

Neither the Reagan Administration nor the preceding Carter Administration recommended a continuation of this program, but we regard that position as short-sighted and mistaken.

The economic emergency loan program has helped 115,000 farmers stay in farming. Without such a program, the end of the road could come in late 1981 or early 1982 for many thousands of efficient and productive farm operators, who are in economic difficulty through no fault of their own.

Since the program functions through the insuring or guaranteeing of loans by the FmHA, the net costs of the program to the U.S. Treasury (and to taxpayers) will be negligible. But to the farm operators who are helped, it will mean survival.

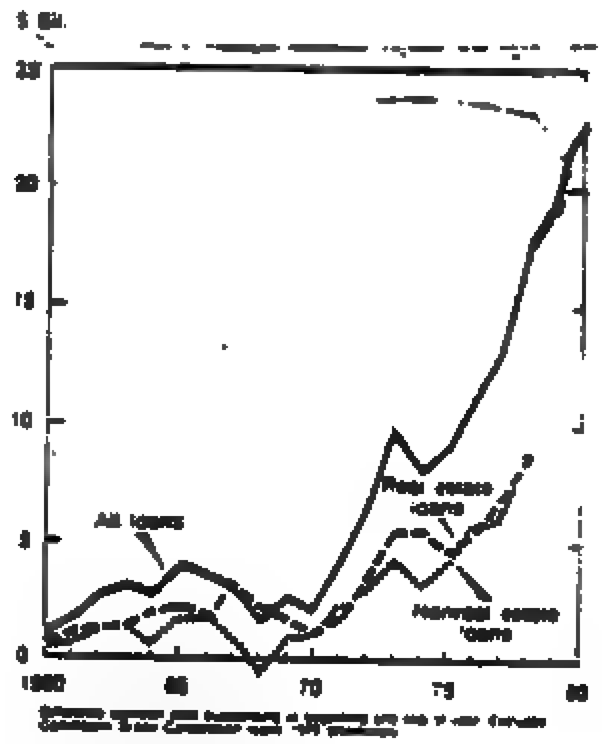
ATTACHMENT "A"

OUTSTANDING FARM DEBT, ANNUAL CHANGE IN DEBT AND THE COMPOSITION OF FARM DEBT

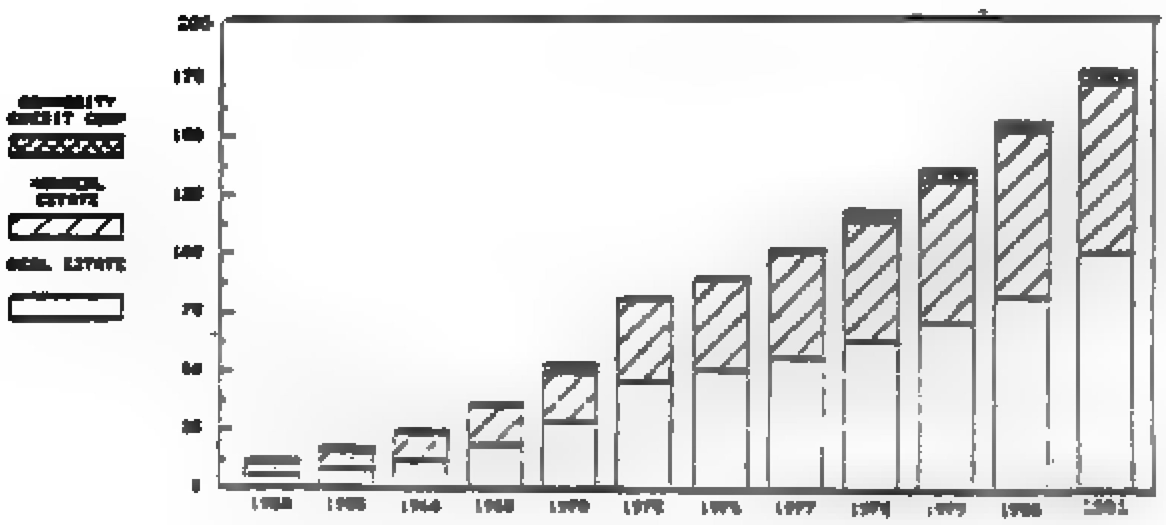
Outstanding Farm Debt
As of January 1

Year	Debt in Bil. $	Increase in Bil. $	Increase in %
1960	24.8		
1970	53.0	28.2	113.0%
1971	54.5	1.5	2.8%
1972	59.1	4.6	8.4%
1973	65.3	6.2	10.4%
1974	74.1	8.8	13.4%
1975	81.8	7.7	10.3%
1976	90.8	9.0	11.0%
1977	102.7	12.1	13.3%
1978	119.3	16.6	16.1%
1979	137.5	18.2	15.2%
1980	157.8	20.3	14.8%
1981	180.5	22.7	15.0%

Annual Change in Farm Debt



REAL ESTATE, NON-REAL ESTATE AND OTHER FARM DEBT



1980 and 1981 projected

ATTACHMENT "B"

THE PRIME INTEREST RATE —— NOW ALMOST 8 TIMES HIGHER THAN IN 1949

Year	Prime Rate *
1949	2.00
1950	2.07
1951	2.56
1952	3.00
1953	3.17
1954	3.05
1955	3.16
1956	3.77
1957	4.20
1958	3.83
1959	4.48
1960	4.82
1961	4.50
1962	4.50
1963	4.50
1964	4.50
1965	4.54
1966	5.63
1967	5.61
1968	6.30
1969	7.96
1970	7.91
1971	5.72
1972	5.25
1973	8.03
1974	10.81
1975	7.86
1976	6.84
1977	6.83
1978	9.06
1979	——

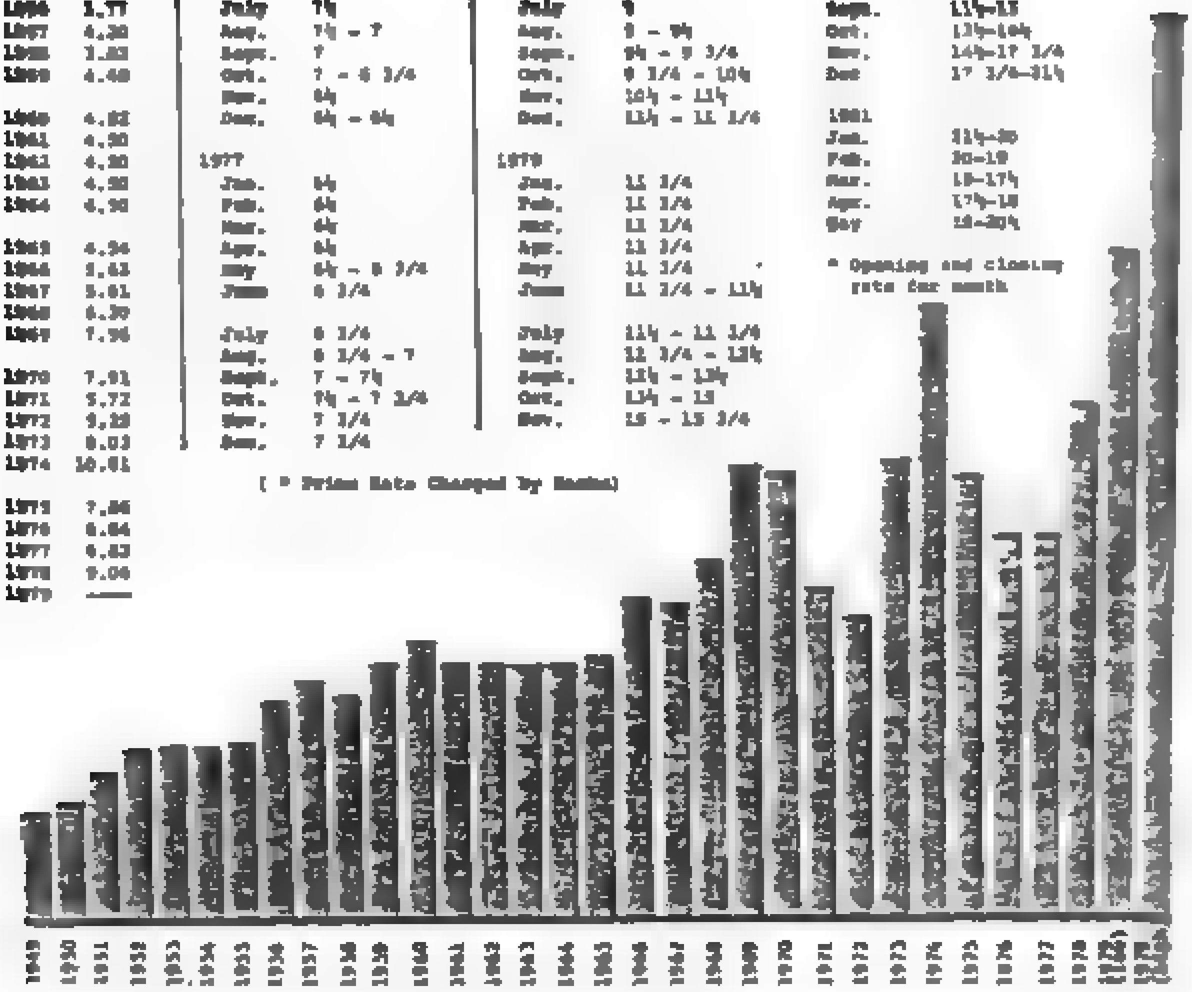
Year & Month	Prime Rate
1976	
Jan.	7¼ - 6 3/4
Feb.	6 3/4
Mar.	6 3/4
Apr.	6 3/4
May	6 3/4
June	7 - 7¼
July	7¼
Aug.	7¼ - 7
Sept.	7
Oct.	7 - 6 3/4
Nov.	6½
Dec.	6½ - 6¼
1977	
Jan.	6¼
Feb.	6¼
Mar.	6¼
Apr.	6¼
May	6¼ - 6 3/4
June	6 3/4
July	6 3/4
Aug.	6 3/4 - 7
Sept.	7 - 7¼
Oct.	7¼ - 7 3/4
Nov.	7 3/4
Dec.	7 3/4

Year & Month	Prime* Rate
1978	
Jan.	7 3/4 - 8
Feb.	8
Mar.	8
Apr.	8
May	8 - 8¼
June	8¼ - 9
July	9
Aug.	9 - 9¼
Sept.	9¼ - 9 3/4
Oct.	9 3/4 - 10¼
Nov.	10¼ - 11½
Dec.	11½ - 11 3/4
1979	
Jan.	11 3/4
Feb.	11 3/4
Mar.	11 3/4
Apr.	11 3/4
May	11 3/4
June	11 3/4 - 11½
July	11½ - 11 3/4
Aug.	11 3/4 - 12¼
Sept.	12¼ - 13¼
Oct.	13½ - 15
Nov.	15 - 15 3/4

(* Prime Rate Changed by Banks)

Year & Month	Prime Rate*
1980	
Jan.	15¼
Feb.	15¼-16 3/4
Mar.	16 3/4-19½
Apr.	19½
May	19½-14
June	14-12
July	12-11
Aug.	11-11¼
Sept.	11½-13
Oct.	13½-14½
Nov.	14½-17 3/4
Dec	17 3/4-21½
1981	
Jan.	21½-20
Feb.	20-19
Mar.	19-17½
Apr.	17½-18
May	18-20½

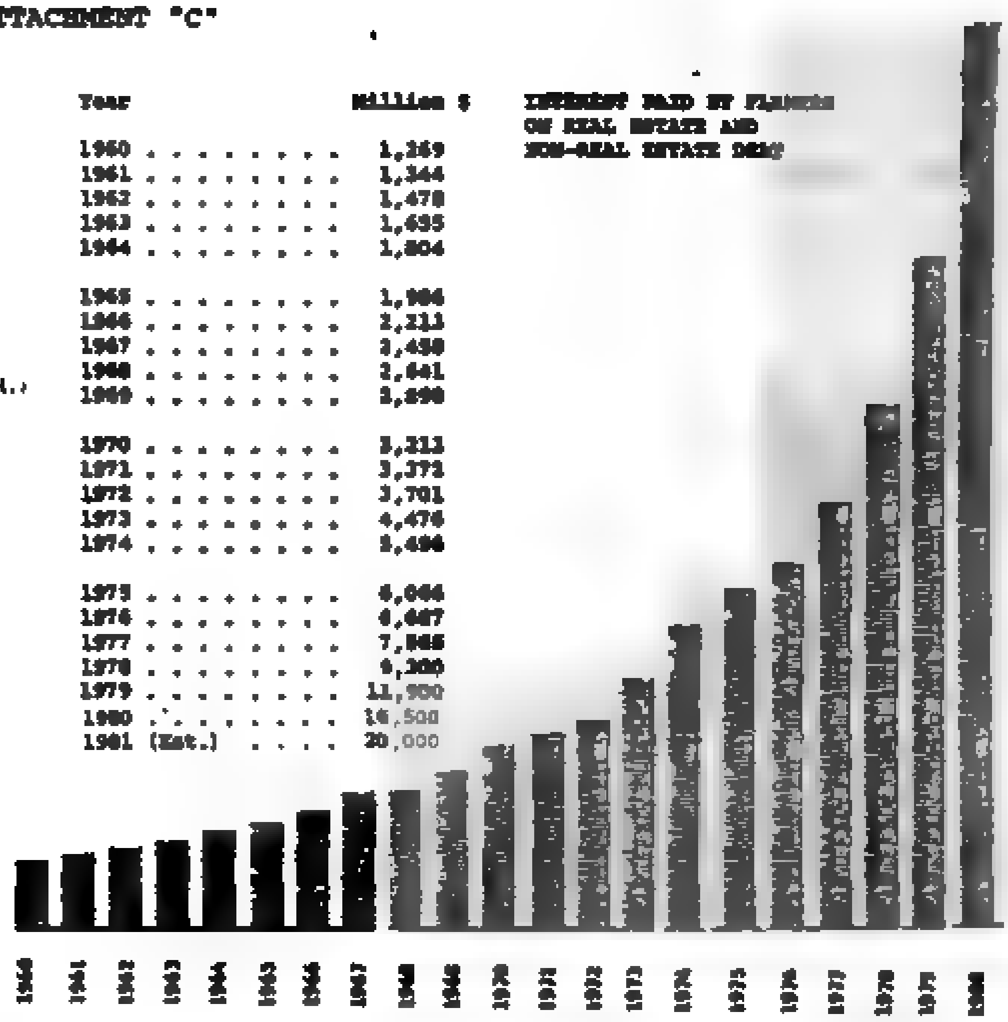
* Opening and closing rate for month

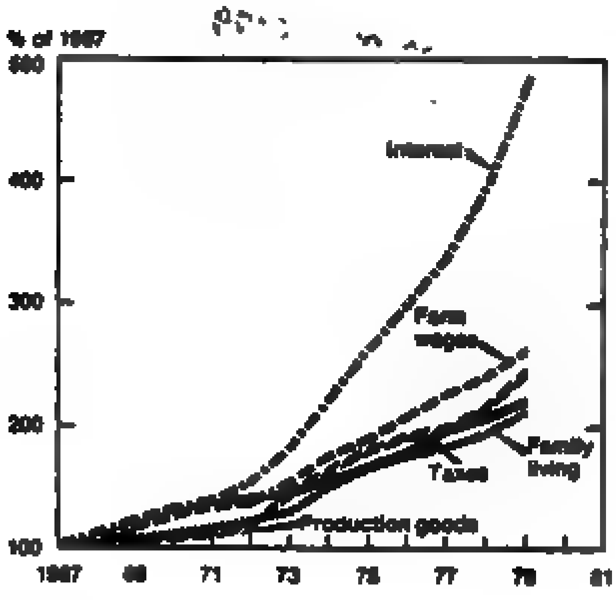


ATTACHMENT "C"

Year	Million $
1960	1,269
1961	1,344
1962	1,478
1963	1,635
1964	1,804
1965	1,986
1966	2,211
1967	2,458
1968	2,641
1969	2,898
1970	3,211
1971	3,372
1972	3,701
1973	4,476
1974	5,486
1975	6,066
1976	6,667
1977	7,865
1978	9,300
1979	11,900
1980	16,500
1981 (Est.)	20,000

INTEREST PAID BY FARMERS ON REAL ESTATE AND NON-REAL ESTATE DEBT





FARM INTEREST OUTLAYS

UP 5 TIMES SINCE 1967

UP 11 TIMES OVER 1960

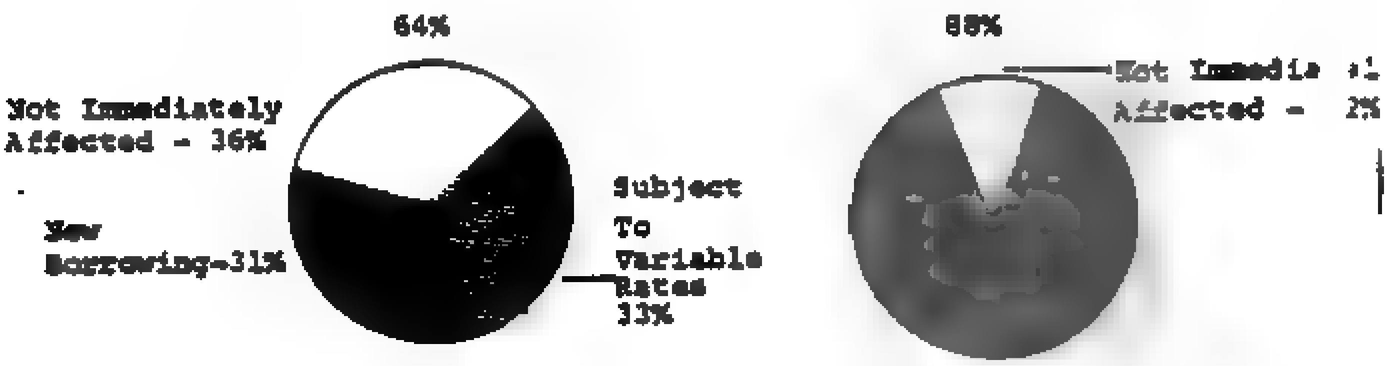
Prices Farmers Pay

	1975	1976	1977	1978	1979[1]
	Percentage of 1967				
Production	182	190	200	216	246
Interest[2]	262	299	338	398	467
Taxes[3]	168	178	188	207	221
Farm wage rates	187	210	226	243	[illegible]

[1] January-May average. [2] Interest on farm real estate debt. [3] Taxes on farm real estate.

ATTACHMENT "D"

ESTIMATED SHARE OF FARM DEBT BURDEN EXPOSED TO CHANGES IN EFFECTIVE INTEREST RATES



ATTACHMENT "E"

FARM DEBT TO ASSET RATIO
1940 - 1979

Year	%	Year	%	Year	%	Year	%
1940	18.9	1950	9.3	1960	11.8	1970	16.8
1941	19.1	1951	8.5	1961	12.4	1971	16.7
1942	16.6	1952	8.6	1962	13.0	1972	16.8
1943	13.4	1953	9.6	1963	13.8	1973	16.6
1944	10.6	1954	10.3	1964	14.6	1974	15.5
1945	8.9	1955	10.5	1965	15.1	1975	15.8
1946	7.6	1956	10.8	1966	15.6	1976	15.7
1947	7.2	1957	10.6	1967	16.0	1977	15.7
1948	7.2	1958	10.7	1968	16.5	1978	16.7
1949	8.4	1959	11.3	1969	16.7	1979	16.8
						1980	18.1

ATTACHMENT "F"

INCREASE IN BORROWING BY FARMERS AS SOURCE OF CASH FUNDS

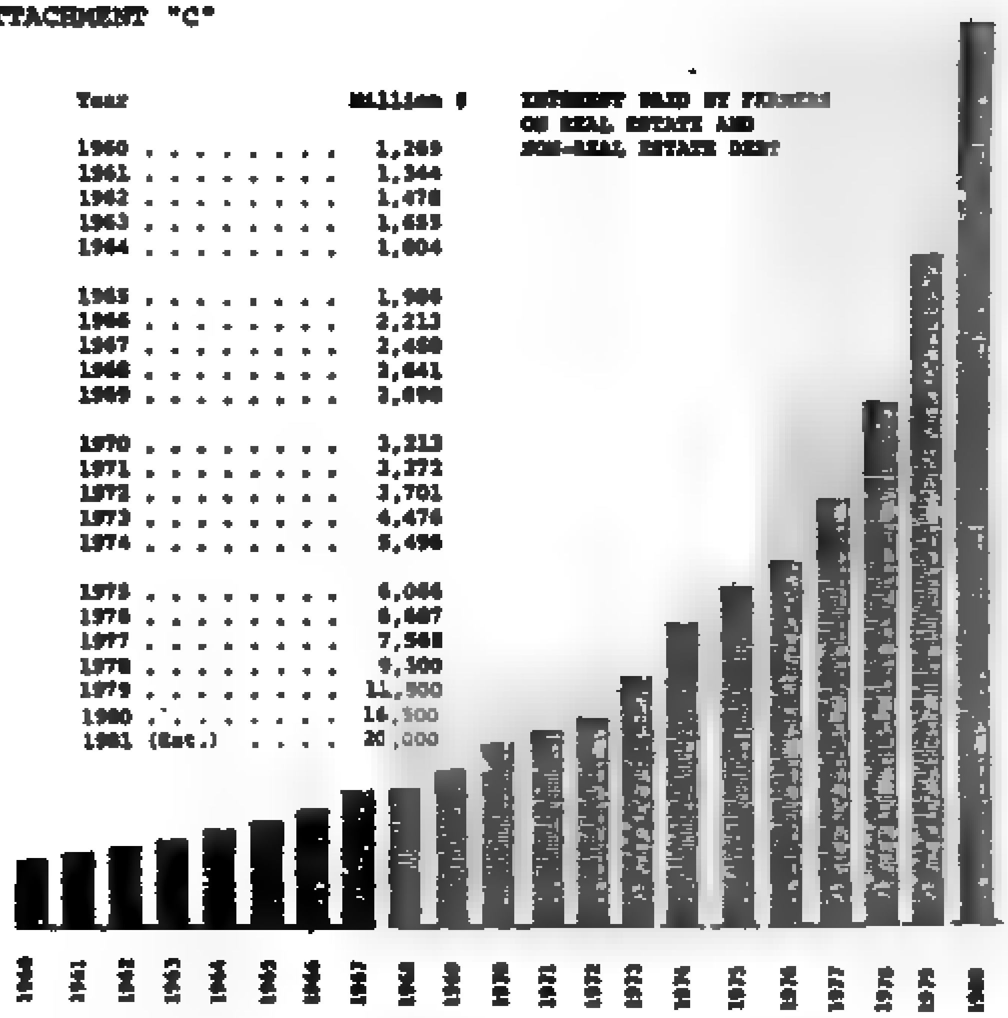
Cash Sources and Uses of Funds in the Farm Sector 1970-1979

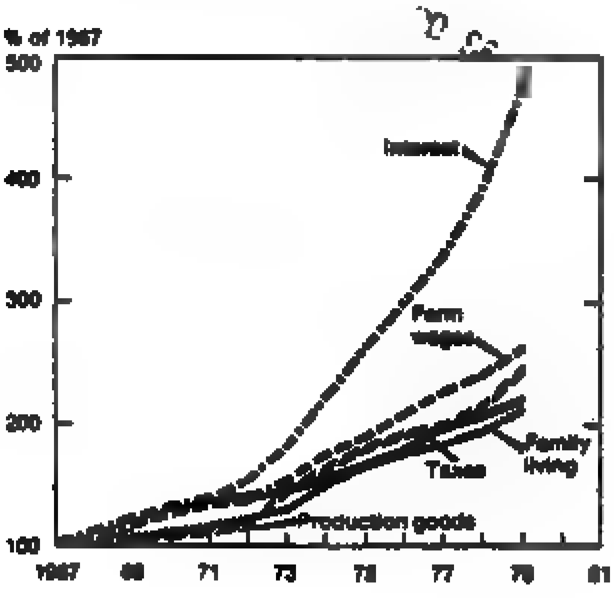
Items	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Cash Sources of Funds	Billion dollars										
1 Net cash receipts from farm and nonfarm sources	[illegible]	38.7	[illegible]	[illegible]	63.4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2 Net flow of real estate loans	[illegible]	1.7	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3 Net flow of non-real estate loans	[illegible]	2.4	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	10.2	[illegible]
4 Total cash sources of funds	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

ATTACHMENT "C"

INTEREST PAID BY FARMERS ON REAL ESTATE AND NON-REAL ESTATE DEBT

Year	Million $
1960	1,269
1961	1,344
1962	1,478
1963	1,635
1964	1,804
1965	1,986
1966	2,213
1967	2,480
1968	2,641
1969	2,898
1970	3,213
1971	3,272
1972	3,701
1973	4,474
1974	5,496
1975	6,046
1976	6,687
1977	7,568
1978	9,300
1979	11,500
1980	16,500
1981 (Est.)	20,000





FARM INTEREST OUTLAYS

UP 5 TIMES SINCE 1967

UP 11 TIMES OVER 1960

Prices Farmers Pay

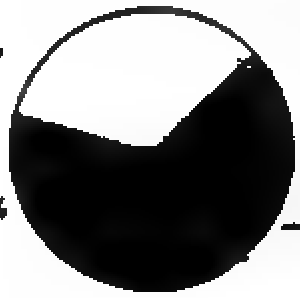
	1975	1976	1977	1978	1979[1]
	Percentage of 1967				
Production	182	193	200	214	240
Interest[2]	262	290	330	386	467
Taxes[3]	165	178	189	207	221
Farm wage rates	199	210	228	242	262

[1] January-May average. [2] Interest on farm real estate debt. [3] Taxes on farm real estate.

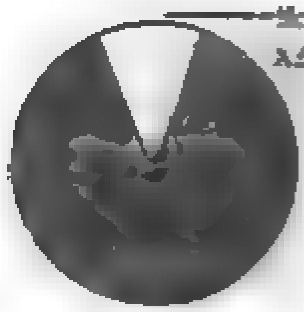
ATTACHMENT "D"

ESTIMATED SHARE OF FARM DEBT BURDEN EXPOSED TO CHANGES IN EFFECTIVE INTEREST RATES

REAL ESTATE DEBT



NON-REAL ESTATE DEBT



Not Immedia[illegible] Affected - [illegible]%

ATTACHMENT "E"

FARM DEBT TO ASSET RATIO
1940 - 1979

Year	%	Year	%	Year	%	Year	%
1940	18.9	1950	9.3	1960	11.8	1970	16.9
1941	19.1	1951	8.5	1961	12.4	1971	16.7
1942	16.6	1952	8.6	1962	13.0	1972	16.8
1943	13.4	1953	9.6	1963	13.8	1973	16.6
1944	10.6	1954	10.3	1964	14.6	1974	15.5
1945	8.9	1955	10.5	1965	15.1	1975	15.8
1946	7.6	1956	10.8	1966	15.6	1976	15.7
1947	7.2	1957	10.6	1967	16.0	1977	15.7
1948	7.2	1958	10.7	1968	16.5	1978	16.7
1949	8.4	1959	11.3	1969	16.7	1979	16.8
						1980	18.1

ATTACHMENT "F"

INCREASE IN BORROWING BY FARMERS AS SOURCE OF CASH FUNDS

Cash Sources and Uses of Funds in the Farm Sector 1970-1979

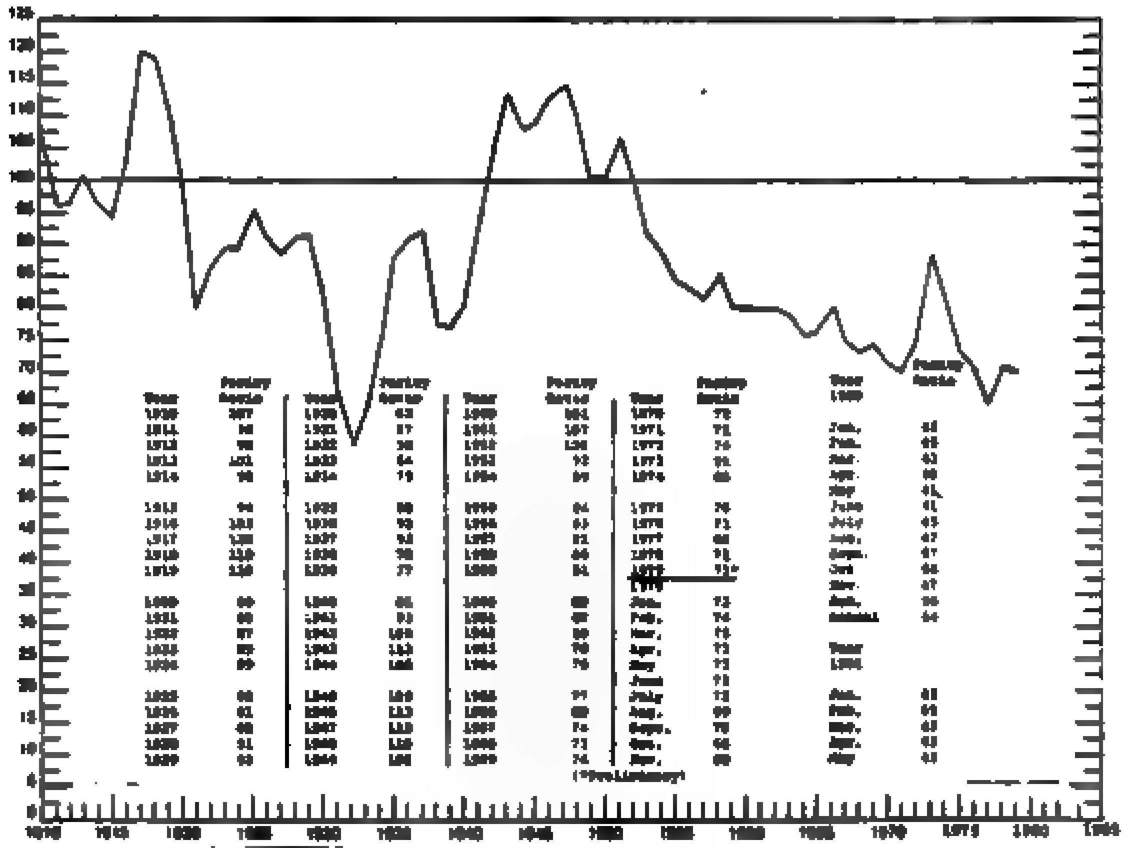
Item	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Cash Sources of Funds	Billion dollars										
1 Net cash receipts from farm and nonfarm sources	37.9	39.7	46.2	[illegible]	63.4	64.5	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2 Net flow of real estate loans	1.3	1.7	3.2	[illegible]	[illegible]	4.3	4.9	[illegible]	[illegible]	[illegible]	[illegible]
3 Net flow of nonreal estate loans	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	5.7	[illegible]	[illegible]	[illegible]	[illegible]
4 Total cash sources of funds	42.5	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]tion of Cash Funds	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	40%

ATTACHMENT "G"

MEASURES OF ABILITY TO REPAY FARM INDEBTEDNESS

Item I

U.S. FARM PARITY RATIO



Item II

COMPARISON OF PER CAPITA INCOME OF FARMERS FROM FARMING

WITH PER CAPITA INCOME OF NON-FARMERS

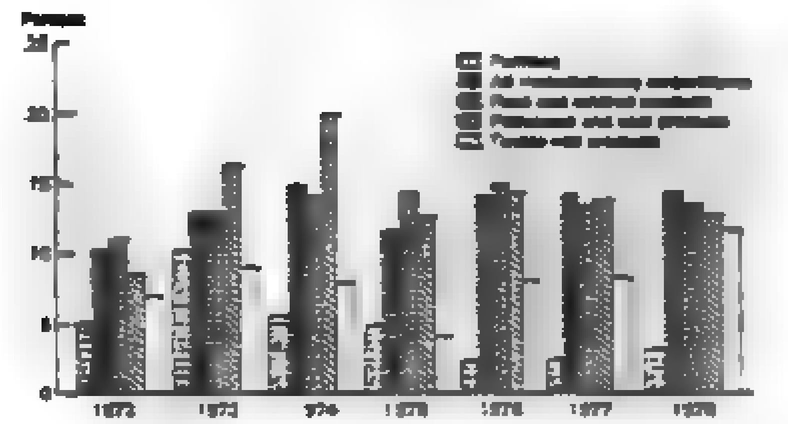
1979

Per Capita Income of Farmers from Farming as a % of Non-farm 63%

ATTACHMENT "G" (Continued) MEASURES OF ABILITY TO REPAY

Item III

Return to Farm Equities and Annual Rates of Profits on Stockholders Equities for Manufacturing Industries.



[illegible]

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Item IV

VALUE OF FARM ASSETS IN 1967 DOLLARS
1975-1979
(Jan. 1)

	1975	1976	1977	1978	1979
	Billion dollars				
Physical assets:					
Real estate	187.7	187.4	187.3	187.2	187.8
Nonreal estate:					
Livestock[1]	22.2	22.4	23.8	19.9	19.2
Machinery and motor vehicles	30.9	30.5	31.1	31.1	31.2
Crops stored on and off farms[1]	9.6	11.8	11.4	14.0	13.9
Household equipment and furnishings	9.0	9.5	9.8	10.9	12.0
Financial assets:					
Deposits and currency	6.8	6.3	6.9	7.0	7.2
U.S. savings bonds	3.3	2.4	2.3	2.1	2.1
Investments in cooperatives	6.8	7.0	7.2	7.4	7.2

Attachment "B"

AVERAGE PRICE RECEIVED
-
AVERAGE PRICE RECEIVED AS A % OF PARITY

January 1980 - June 1981

	WHEAT		CORN		SOYBEANS	
1980	**$/Bu.**	**% of parity**	**$/Bu.**	**% of parity**	**$/Bu.**	**% of parity**
Jan.	$3.62	58	$2.25	52	$6.06	56
Feb.	3.75	59	2.36	54	6.14	55
Mar.	3.62	56	2.31	52	5.92	53
Apr.	3.40	53	2.31	52	5.50	49
May	3.62	56	2.40	54	5.71	51
June	3.55	55	2.43	54	5.76	51
July	3.82	58	2.73	60	6.97	61
Aug.	3.86	58	2.93	64	6.99	60
Sept.	3.97	59	3.03	65	7.69	66
Oct.	4.19	62	3.03	65	7.82	67
Nov.	4.34	64	3.20	68	8.42	71
Dec.	4.09	60	3.20	68	7.26	61
1981						
Jan.	4.22	61	3.32	69	7.54	62
Feb.	4.06	58	3.22	67	7.13	58
Mar.	3.93	56	3.16	65	7.10	58
Apr.	3.99	56	3.20	66	7.33	59
May	3.96	56	3.20	66	7.29	59
June	3.67	52	3.16	65	6.99	56
		57.6		61.4		58.5

83-025 0 - 81 - 47

OREGON CONSUMER LEAGUE

[illegible] S.W. Third Avenue, Room [illegible]
Portland, Oregon [illegible] ([illegible]), [illegible]

July [illegible], [illegible]

Chairman
Subcommittee on Financial Institutions
Senate Banking, Housing and Urban Affairs Committee
Senate Office Building
Washington, D.C. [illegible]

Dear Mr. Chairman:

The Oregon Consumer League is strongly against the proposals outlined in S.[illegible], the measure preempting all state usury ceilings.

We feel that the language of the bill is far too broad, and would endanger the ability of this nation's consumers to obtain loans at fair and equitable rates. One need only look at the interest charges present in states that have removed their ceiling limits to uncover the exorbitant rates that can result. For example, some creditors in Arizona are charging annual rates of 50%, more than doubling the finance charges paid by consumers under the old rate.

We hope that you will accept our comments as an official part of the testimony against S.[illegible], and that you will refuse to support this proposal.

Respectfully,

David S. Shannon
President
Oregon Consumer League

[illegible]

UWEX UNIVERSITY OF WISCONSIN—EXTENSION
UNIVERSITY OF WISCONSIN—MILWAUKEE

929 NORTH SIXTH STREET MILWAUKEE WISCONSIN 53203 AREA CODE 414 224-4177

CENTER FOR CONSUMER AFFAIRS

August 13, 1981

Senator Christopher Dodd
Committee on Banking, Housing and Urban Affairs
5300 Dirksen Senate Office Building
Washington, DC 20510

Attn: Peter Kinzler

Dear Senator Dodd:

I am Pleased to have been afforded the opportunity to comment upon S. 1406, the "Credit Deregulation and Availability Act of 1981." I will structure my comments in two sections, offering first, observations on usury ceilings generically, and second, comments on S. 1406 specifically.

It is well established that individual States have "... a substantial interest in the rates paid by [their] residents... for the use of money...." Alden's, Inc. vs. Packel, Third Circuit, Nos. F4-1971, F4-1972, 8-27-75, CCH Consumer Credit Guide para. 98,544 @ p. 88,011. This interest is undoubtedly founded at least in part on the enormous amounts of money involved in consumer credit transactions. Total outstanding consumer installment credit (exclusive of mortgage credit) in the United States at the end of May, 1981 was $315,465,000,000. Fed. Res. Bulletin, July, 1981, p. A40 A change of 1% in the interest rate charged on such amount would cause a change in the interest paid by consumers in one month on such amount of approximately $262,887,500. Put another way, a 4% APR change in the rate charged on such an amount would result in additional interest payments of roughly $5 per month per capita in the United States, or about $60 per year per capita. Since large numbers of the population use consumer credit sporadically, if at all, the cost of such an increase to users of such credit would be much higher. Clearly, the individual States have "substantial interests" in what their citizens pay for credit.

Given the enormous potential costs to consumers, it seems logical to perform a "cost-benefit" analysis on a proposal which would pre-empt

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state ceilings (particularly, given the high esteem which this technique is afforded in many parts of the government). The first potential benefit alleged in favor of eliminating interest rate ceilings is in enhanced availability of such credit albeit at a higher cost. (Inherent in this "no-credit" vs. "more expensive credit" dichotomy is the fundamental philosophical notion of whether government has an appropriate role in admittedly paternalistically "protecting" consumers by controlling the price of credit.) The following table shows total consumer installment credit in the United States since November, 1979.

Month	Total Outstanding (in millions)	Change from Prior Month*
Nov., 1979	307,641	2,407
Dec., 1979	311,122	1,349
Jan., 1980	308,984	1,372
Feb., 1980	308,190	2,295
Mar., 1980	307,621	1,437
Apr., 1980	306,131	-1,985
May, 1980	305,788	-2,677
June, 1980	304,399	-2,045
July, 1980	303,853	-1,199
Aug., 1980	305,763	489
Sept., 1980	306,926	1,065
Oct., 1980	307,222	702
Nov., 1980	308,051	839
Dec., 1980	313,435	1,619
Jan., 1981	310,554	869
Feb., 1981	309,188	1,996
Mar., 1981	310,766	3,108
Apr., 1981	313,419	2,331
May, 1981	315,465	1,346

Source: Fed. Res. Bulletins July, 1980 (p. A42); Jan, 1981 (p. A40); July, 1981 (p. A40)

* Figures seasonally adjusted

What this indicates is a steady pattern of growth in consumer credit outstandings, with the exception of the period from April through July, 1980. This exceptional period overlaps almost identically with the period of credit controls imposed Mar. 14, 1980 when reduction in the growth of consumer credit was an avowed national purpose. Indeed, the seasonally adjusted net change in the last five months on the chart was $9,650 millions, while the seasonally adjusted net change in the last five months prior to the imposition of credit controls expressly intended to

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reduce the growth of consumer credit was $8,860 millions. Thus, consumer credit is growing faster now than it was immediately prior to the imposition of credit controls intended to slow the growth of credit!* This seems to cast some doubt on allegations that consumer credit is generally unavailable.

Additional figures from the Federal Reserve Board seem to belie arguments that credit is relatively unavailable. Seasonally adjusted figures from the halcyon days of January through July, 1979, reveal that average monthly extensions of consumer installment credit were $26,632 millions. (Fed. Res. Bulletin, Sept., 1979, p. A43) Average monthly extensions of similar credit for the seven months from Nov., 1980 through May, 1981 were $27,965 millions. (Fed. Res. Bulletin, July, 1981, p. A41) While this represents an increase of only 5.0% in 22 months, it hardly seems as if credit is largely unavailable, particularly when considered in light of a significant concomitant increase in unemployment.

The final observation I would make on the unavailability argument stems from its source. I am unaware of any groups who are seriously and aggressively advancing the notion that credit is unavailable due to interest rate ceilings other than creditors and creditor groups. While this does not necessarily disprove the validity of such an argument, it seems at least to call it into serious question. If credit were generally unavailable due to interest rate ceiling (as opposed to its unprecedentedly high cost), it would seem logical to expect that consumers and consumer groups would be pushing for the removal of such obstacles. It is my understanding that these groups are generally opposing this course of action.

Another argument advancing an alleged benefit of repealing State interest rate ceilings is that cross-subsidies created by such ceilings would be eliminated. The notion is that unrealistically low rate ceilings force creditors to charge the same rate - the ceiling - to all accepted borrowers, both low - risk and high - risk. Thus, lower - risk borrowers are subsidizing higher - risk borrowers. By eliminating ceilings, the theory goes, higher - risk borrowers can be charged rates related to their higher risk and thus won't be subsidized by lower - risk borrowers. This theory rests on several assumptions. The most important is that creditors will actually distinguish among their consumer borrowers as to risk and price their credit accordingly. The fact is that it is uneconomical for most extenders of consumer credit to make such distinctions due to the relatively small amounts of credit (and thus the relatively small amount of profit per transaction) involved. I am unaware of any credit card plan,

* Admittedly, the current growth rate is less than it was in mid-1979, but it is nonetheless a significant growth rate.

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for example, which allows different risk customers to pay different rates, even in states which have repealed all rate restrictions on such plans. In short, the market is efficient only insofar as it avoids undertaking unwarranted costs and is inefficient in the sense that it generally doesn't distinguish (for perfectly valid economic reasons) among individual borrowers on the basis of risk. Thus, what results is a system where an individual either qualifies, and pays a systemically - determined rate, or doesn't qualify. Thus, cross - subsidies among individual consumers would continue to exist in many consumer credit markets following preemption, but at a higher systemic rate.

Even if one assumes that unrealistic State usury ceilings are causing consumer credit to be unavailable, one must examine the propriety of federal involvement in an area which has historically been occupied by the States. One can be reasonably certain that the various arguments against unduly restrictive rate ceilings have been forcefully and articulately made at the state level. The sheer magnitude of the financial interests of the various consumer creditors assures this conclusion. The results of such legislative pressures are rather clear. Approximately 36 States have repealed or eased some or all of their interest rate ceilings in the past two years. (See generally, CCH Consumer Credit Guide para. 4178). An additional 10 States (CO, ID, IN, IA, KS, ME, OK, SC, UT and WY) had previously adopted the Uniform Consumer Credit Code in part or whole, with its relatively unrestrictive ceilings. (CCH Consumer Credit Guide para. 4770) Thus, it seems incongruous to argue that States are (or have been) unresponsive to money - cost pressures. And if this is (and has been) the case, questions arise as to the necessity for federal involvement, particularly given the divergent characteristics among creditor populations and consumer behavior in the various States.

Still, it may well be (as some have suggested) that elimination of State usury ceilings is an idea that is irresistable when considered on its merits. This suggests that State legislatures which have eased (but not repealed) interest rate ceilings are incapable of seeing or unwilling to enact such a concept despite its theoretical and practical correctness. Absent such inclination on the part of the various States, it would then be incumbent on the federal government (which seemingly then would be uniquely capable of recognizing such a verity) to repeal these anachronistic State laws. If this is indeed the case, then it is conceptually indefensible to permit the States to subsequently "opt - out" of the federally - preempted wisdom and to reinstate their own narrow and misguided ideas. Thus, it should not be troublesome simply to overrule these actions by the States (made through their duly elected Legislatures) and simply be done with it.

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Unfortunately, many thoughtful persons, consumers and creditors alike, are not convinced that total elimination of usury ceilings is unquestionably correct.

There is no question that the federal government has been involved in the establishment of ceilings on interest rates in the consumer credit field. In the area of non-mortgage consumer credit, this involvement has been for the purpose of shaping the competitive structure of such markets. Over a century ago, the federal government granted a preferential competitive position to nationally chartered banks by means of 12 USC 85. This statute established the status which has come to be known as "most favored lender status." This provision allows nationally chartered banks a competitive position vis-a-vis the interest rates which they may charge which is no worse than the most lenient rate position allowed to any other lender competing in that state. Historically, this has generally allowed nationally chartered banks to impose rates otherwise reserved to small loan companies. This was consciously done to give such banks a favorable competitive position, and has consistently been upheld by the US Supreme Court, despite a recognition of the tenuous economic advisability of such a position.

Similarly, the federal government has recently acted in the area of rate ceilings in the Depository Institutions Deregulation and Monetary Control Act of 1980 (MCA). Public Law 96-221, March 31, 1980. Sections 521, 522 and 523 of such act permit state chartered insured banks, savings and loan associations, and credit unions, respectively, to make loans at rates up to "1 per centum in excess of the discount rate on ninety-day commercial paper" in the Federal Reserve District in which the institutions are located, the so-called FRB discount rate plus one. The FDIC and the FHLBB have interpreted those sections even more broadly, namely, to grant "most favored lender status" to affected institutions, while at least one consumer credit regulator (the Wisconsin Commissioner of Banking) has rejected that view, holding that the MCA grants only the authority to charge the FRB discount rate plus one. Who is correct as between these regulators is unimportant for the purposes of this argument. What is important is that the MCA was intended to promote competitive ends. Indeed, the operative language of § 521 is prefaced by a statement of purpose: "In order to prevent discrimination against State-charted insured banks...." Thus, the purpose of this most recent federal involvement in setting rate ceilings was not deregulation, but rather, was to adjust the relative competitive positions of ostensibly competing purveyors of non-mortgage consumer credit. This purpose is clearly distinguishable from an intent to remove controls from allowable interest

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rate charges. Accordingly, federal involvement in this area has been to set ceilings, not eliminate them. Elimination of ceilings is founded upon a totally different, totally unique set of economic principles, it is intended for totally different purposes, and it represents a radically new direction for federal involvement in rate ceiling setting.

It has been argued that State usury ceilings have adversely affected the sale of large-ticket items, particularly automobiles, and that removal of such obstacles will beneficially stimulate these sagging areas of our economy. Whether it is high interest rates or the high price of the underlying product that is choking off auto sales is difficult to determine. If it is the former, than clearly rate ceilings should be eased; however, if it is the latter, relaxation of ceilings will do little, if anything, to spur car sales. The preemption of state rate ceilings on first-mortgage lending in April, 1980, by the MCA has not dramatically reversed the precipitous decline in residntial housing activity since its enactment. Nor have restrictive rate ceilings so depressed the sales of Japanese automobiles that the government did not feel the need to "persuade" the Japanese to restrain their exports to this country. High interest rates certainly don't help automobile sales, but it is far from clear that preempting state rate ceilings will significantly ameliorate the situation.

Finally, one must consider the propriety of federal involvement in preempting rate ceilings of differing States which possess significantly differing creditor populations and whose consumer populations use and handle their consumer credit in widely diverging manners. Arkansas relies heavily on retail sale credit; few, if any, consumer finance companies are active in Maine; credit unions are much more heavily used in some states than others; industrial banks are a force in several Rocky Mountain states while being non-existant in other parts of the country. The point is that consumer credit is available in widely differing forms, at differing costs, from differing institutions. Similarly, consumers use credit differently. The largest bankcard program in Wisconsin reports about 45% of their cardholders in any given month will pay their outstanding balances in full within the so-called grace period, while the national figure is roughly 30-35% of such cardholders. Accordingly, various States have enacted their consumer credit laws to address different situations. To preempt such enactments by the mechanism of such a broad-brush stroke raises serious questions.

I would now like to address some specific comments to S. 1406.

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Sec. 531 of the bill would preempt all State laws which limit "the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges ...." I submit this language is extremely broad, especially since "covered charges" include "... any other compensation paid to the creditor or arising out of the credit agreement or transaction for the use of credit or credit services...." Many more laws than merely those dealing explicitly with interest rate ceilings would be preempted. For example, the bill would likely preempt limitations on delinquency charges. "Covered charges" explicitly do not include "amounts paid to the creditor ... that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the ... agreement...." In the event an installment is not paid, the "terms" of the agreement may provide for a delinquency charge of, for example, $3.00 as per WIS. STATS. § 422.203. As the charge is specifically a "term or condition" of the agreement, it may have arisen effectively as an election by the borrower of an option under the agreement, i.e. to delay making a scheduled payment at an agreed-upon charge of $3. Since the charge is specifically agreed to in the event of a certain contemplated eventuality, it does not constitue a "failure" or "refusal" of the debtor to comply with the agreement, and thus is not excludable from "covered charges."

Similarly, the bill would preempt State restrictions on what can be charged by the creditor for credit insurance. This would permit or even encourage the burying of additional charges in credit insurance which can easily be excluded from the Truth-in-Lending disclosures of the finance charge, thus subverting the primary disclosure purpose of the Truth-in-Lending Act.

The words "failure or refusal" in the definition of "covered charges" seem to contemplate exempting from the preemption (albeit unsuccessfully, in my opinion, supra) only elements related to delinquency. Thus, state restrictions on rebates upon prepayment, such as outlawing the use of the rule of 78's, would also be preempted. Further, state restrictions on front-end fees and charges would also be stricken.

Finally, I am troubled by the term "solely" in the exception language in the definition of "covered charges" in § 532 (a) (1) (A). An unscrupulous creditor could insert a specious "condition" into the contract (for example, if the prime rate exceeds 10%) which could be a trigger for a delinquency charge and invoked when it coincides with non-payment.) Thus, the charge is not "solely" for the failure or refusal to comply with

Senator Christopher Dodd
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the terms of the agreement, and is thus a "covered charge."

Sec. 534 would authorize the Federal Reserve Board to issue "interpretations" with respect to Sec. 531. While this will undoubtedly be critically important given the vagueness of the Act, left unsaid is what, if any, weight will be accorded these interpretations. The Federal Reserve Board will thus be rendering what amounts to judicial interpretations of state laws, with uncertain import afforded those interpretations. The result may well be a body of "interpretations" of mind-numbing complexity similar in volume to Regulation Z, interpreting the Truth-in-Lending Act without the authority the Milhollin case afforded Regulation Z.

In conclusion, this bill will permit enormous costs to be assessed against consumers of credit. It is highly speculative at best that any benefit will be realized by borrowers in the form of greater availability of credit, especially since the evidence indicates no dearth of credit availability currently. The bill is unlikely to ameliorate cross-subsidies among consumers of credit. It is likely to be an administrative nightmare, particularly in the future, as decisions about the regulation of consumer credit pricing, which have historically been made by the various States, will be made by the federal government, regardless of the variations in credit markets and credit consumers throughout the country.

Thank you for inviting me to comment on this important issue.

Very truly yours,

James L. Brown

James L. Brown
Director

JLB/bo

Statement in Opposition to S. 1406

by John A. Gronouski

My name is John A. Gronouski. I am a Professor of Public Affairs and Economics at the Lyndon B. Johnson School of Public Affairs, University of Texas at Austin. My resume is attached to this statement I should note, in addition, that during the 1980-81 academic year I directed, at the request of the Speaker of the Texas House of Representatives, a study of the impact of Texas usury laws on its consumer finance industry A copy of that study has been sent to the minority counsel of the Committee on Banking, Housing and Urban Affairs.

I speak in opposition to S. 1406 for two reasons: first, because it provides for federal preemption of state statutes and constitutional provisions in an area which has historically been the province of the states and, second because enactmen of Title II of the Bill will inevitably result in a sharp and wholly unwarranted rise in the cost of borrowing to that segment of our society which is least equipped to fend for itself. I will address in turn each of these propositions

Usury laws were first adopted in the United States by the original colonies, and have been a part of the constitution and/or statutes of every state throughout our history The primary focus of state usury laws has been the protection of the state's citizens, particularly those who are in need of relative y small loans, from the so-called loan sharks. Adoption of these laws by state legislatures reflected the view that small borrowers lacked the financial knowledge and bargaining power to protect their own interests in a loan transaction.

There is great diversity among the states with respect to rates, brackets, loan size and repayment periods. Each state legislature has tailored its statutes to accommodate what it perceives are the needs of its own citizens and lending institutions. At a time when both federal executives and legislators are proclaiming the need to shift authority and responsibility for citizen protection and help from the federal government to the states and are enacting legislation to accomplish this objective, it is ironic that the Congress is even considering usurping the right of the states to act independently in what they perceive is in the interest of their own citizens.

I know that under this proposed legislation the states have the option of restoring their authority by enacting new usury laws or constitutional amendments, prior to three years from the date of passage of S. 1406. But I do not need to tell those experienced in the legislative process the emptiness of this provision. I know of no Member of Congress who would accept the repeal of a valued statute or cons itutional provision in exchange for the promise that he or she would be granted an opportunity to introduce legislation aimed at reenacting the repealed statute or constitutional amendment. Knowledgeable people are aware of the difficulty of getting

adopted any one of the thousands of bills that come before a legislature each year, let alone one which would bring forth the concerted and well financed opposition of the entire financial community.

One might make a case for S. 1406 if the record showed that state legislatures have been unresponsive to the needs of the lending industry in the face of sharp increase in the cost of money. But this has not been the case. During 1980 some twenty states have adapted their usury rates, ceilings and brackets to reflect the prevailing level of interest rates, over half of the states have done so since 1978 and the process of upward revision has con inued during the 1981 state legislative sessions. Two states repealed their usury laws in 1980. This is not an area in which state legislatures can be accused of neglecting their responsibilities.

I am particularly concerned over the proposed nullification of state constitutional provisions and laws pertaining to consumer credit contained in Title II, Section 531 of S. 1406. There is a reason why state usury laws typically contain special provisions for the protection of those of its c izens who use the services of consumer finance companies, pawn shops and easy-credit furniture and appliance dealers. It is because those citizens are relatively unsophisticated with respect to both the terminology and the functioning of the financial marketplace. They are no familiar with the real cost differences reflected in terms used in the industry such as add-on interest, APR, discount rate and time-price differential. Moreover, many small loan company customers do not have checking accounts they have had little or no contact with commercial banks and savings and loan associations, and assume (often incorrectly) that their business would not be welcomed by such institutions.

Competition in the marketplace among banks, insurance companies, savings and loan associations and similar types of financial institutions may adequately protect the substantial and financially sophisticated business borrower from paying interest rates in excess of those that would be indicated by supply and demand conditions in the money markets. But this type of protection is not available to the typical applicant for sma l consumer loans. He does not seek out alternatives to the consumer finance company, pawn shop or easy-credit merchant because he does not conceive of the businessman's alternative lending sources having an interest in his business. His belief is supported by the fact that the banks and savings and loans have given no evidence that they are soliciting business such as his.

Companies that deal in consumer loans are in business to make money; it is not unkind to observe nor is it surprising that they charge interest rates as high as the traf ic will bear and the law allows. Our study of the experience in all fifty states revealed no case where consumer finance companies charged rates significantly lower than those permitted by law. Given no apparent alternative source of needed funds, their customers paid the maximum allowable rates.

Usury laws have been the tool used by the states to at least partially offset this disparity in bargaining power. In the process the states have not been unmindful of the need of maintaining a healthy consumer finance industry. Even in 1979, prior to the spate of usury rate increases enacted by the states in their 1980 and 1981 legislative sessions, consumer finance companies in the United States earned a return on net worth, after federal corporation income taxes, of 11.86%.[1]

Elimination of state consumer credit usury laws would remove any semblance of bargaining power balance between small loan lenders and borrowers. Enactment of S. 1406 would inevitably result in a sharp rise in the cost of money to the segment of our working population least able to protect itself. More fundamentally, its passage would effectively deprive the states of their authority and responsibility to enact, maintain, and update usury laws and constitutional provisions designed to promote the general welfare of their own citizens. S. 1406 would be bad law. I recommend that it be repudiated by this Committee.

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[1] Based on reports of 167 consumer finance companies. The reports are compiled by the National Consumer Finance Association, trade association of the consumer finance industry. See NCFA Research Report on Finance Companies in 1979, July 11, 1980, Washington, D. C.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

September 14, 1981

The Honorable John G. Tower
Chairman
Subcommittee on Financial
Institutions
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am writing to express the strong support of the Federal National Mortgage Association (FNMA) for S. 1406, the proposed "Credit Deregulation and Availability Act of 1981." Title II of this bill as introduced would provide for a federal preemption of state usury laws on certain consumer credit transactions, including second mortgage real estate loans, whether secured or unsecured.

FNMA is nearing completion of its development of a conventionally financed second mortgage program. We expect to implement this program in the near future, and believe it will assist in the creation of a national secondary market for second mortgage real estate loans.

There is evidence that the second mortgage has become increasingly important in home finance. This is particularly true now and in the recent past when mortgage interest rates are and have been so high. The Department of Housing and Urban Development recently stated that according to one estimate as much as one-fourth to one-half of home sales in some states now depend on the availability of secondary mortgage finance. HUD added that both buyers and sellers would benefit from the development of a secondary market in second mortgages.

Recently it was reported that according to leading industry estimates, between $15 and $20 billion worth of home equity loans (second mortgages) were made nationwide in 1980, up from an estimated $3-4 billion in the mid-1970's. Our own research supports the proposition that there is a substantial demand for second mortgage financing, and that a national secondary market for these loans seems both necessary and desirable.

3900 WISCONSIN AVENUE N W • WASHINGTON, D C 20016 • (202) 537 6770

The Honorable John G. Tower
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In researching the legal questions involved in developing a second mortgage program, one of the more significant problems we encountered was the wide variety of restrictive state usury and related laws and regulations which would tend to impede a nationwide program. Although other significant problems would remain, the enactment of S. 1406 would be of substantial help in solving the usury law problem.

In introducing S. 1406, Senator Lugar stated that restrictive interest rate ceilings are a problem of national scope and importance and tend to distort financial markets and depress the economy. FNMA agrees. While not unsympathetic to the argument that usury laws should be left to the province of the various states, the argument for stability and the availability of housing finance, in our judgment, is more persuasive.

FNMA urges that your Subcommittee, the Banking Committee, and the Senate itself move favorably and expeditiously on the passage of S. 1406.

In conclusion, I respectfully ask that this letter be made part of the hearing record on S. 1406.

Sincerely,

David Maxwell

DOM/jlc

DATE DUE			